NEGOTIATING AND DOCUMENTING
COMPLEX INTERNATIONAL FRANCHISE AGREEMENTS

Stephen Giles
Partner, Deacons
Melbourne, Australia

Lou H. Jones
Senior Vice President, Corporate and Commercial Law,
Blockbuster Inc.
Dallas, Texas

Larry Weinberg
Partner, Cassels Brock & Blackwell, LLP
Toronto, Ontario

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NEGOTIATING AND DOCUMENTING COMPLEX INTERNATIONAL FRANCHISE AGREEMENTS

I. INTRODUCTION

International expansion is an enticing proposition for the ambitious franchisor. It holds both the promise of large untapped markets, and the allure of the exotic. However, without careful research, planning and execution, an expansion effort can also lead to financial failure. Not only do costs rise with distance, but different legal, economic, cultural and linguistic regimes can all create dangerous pitfalls.

This paper aims to help franchisors increase their odds of success by addressing the avoidable perils of international expansion. The greatest difficulties associated with the international expansion process arise from the fact that, unlike domestic franchise agreements, international franchise agreements require greater adaptability to particular circumstances. With this in mind, we stress the importance of adopting a cautious and proactive approach to the planning and negotiation phases of the expansion process. While franchisors may be tempted to complete these transactions with great haste and parsimony, our collective experience confirms that a reactionary or hurried approach to emerging markets is a poor way to manage risks and meet expectations. On the other hand, a well-planned expansion effort – built around a carefully structured expansion agreement – can anticipate and plan for contingencies.

In the analysis that follows, we draw on our collective experience as franchise lawyers to provide insight for franchisors seeking to expand their business beyond domestic borders. Since international franchise agreements are more commonly subject to negotiation between parties, our analysis includes a series of negotiation tips that may assist the franchisor in reaching an ideal contractual arrangement. In addition, we stress the importance of selecting the appropriate franchise structure, and in some cases provide sample clauses to illustrate how certain contractual terms can be effectively worded. And while the breadth of our analysis may reflect the range in our respective jurisdictions of expertise, the tips provided in this paper are joined by the common themes of planning ahead and negotiating favorable terms before embarking on an international franchise expansion.

II. NEGOTIATION TIPS

A. Overview

The negotiation of an international franchise expansion requires building consensus among various parties. A successful negotiation process will involve interaction between a party’s business or commercial team and the legal team, as well as cooperation among legal counsel on both sides of the transaction. In this section, we highlight the importance of integrating both legal and commercial expertise at the negotiation phase of the expansion process. In particular, we encourage franchisors to make use of legal expertise early on in the negotiation process in order to both enhance the lawyers’ effectiveness and to assist the commercial team with relevant legal advice. We also discuss the importance of engaging local or in-house counsel in order to address budgetary and other issues early on in the negotiation process.

The authors would like to gratefully acknowledge the assistance provided in the preparation of this paper by Simon Flood, Summer Law Student, Cassels Brock & Blackwell LLP, Toronto, Canada.
B. Interfacing with the Business Team

The effectiveness of a lawyer in the negotiation of a transaction is related directly to the extent to which the commercial team is willing to involve legal counsel in the initial stages of the transaction, as well as sustaining this involvement throughout the negotiation process. All too often, the terms of the agreement are brought to the lawyer as a *fait accompli*, and the lawyer is asked only to document the transaction. All transactional lawyers have been in this situation. As we begin to draft the documents, the questions begin. Did they think about this? Did they agree on that issue? Who is responsible for this? The devil is in the details, and all too often the commercial team negotiates only the business terms, or other “big picture” issues. Questions are often less than favorably received. Lawyers are seen as “killing the deal” when, in fact, the agreement is only half negotiated.

There can be an “us and them” attitude between the business team and the legal team. The two, however, need to be integrated for the maximum effectiveness of both. Building relationships with the commercial team is the first step. Combining legal expertise with commercial practicality in advising the team is the second. The business team does not want to hear “No, you can’t;” they want to know “how they can.” Being creative and finding ways to allow the commercial team to accomplish their business goals within legal bounds is the best way to win their confidence and ensure the lawyer’s inclusion in the process.

If the lawyer cannot take part in the negotiations, the commercial team must be informed of potential legal issues in a proper fashion. The business team can and should be educated. This should include explanations on the forms of various agreements to be used, the rationale for the provisions contained in those documents, the potential effects on the brand and franchise system that can result from their decisions, providing negotiation and country-specific checklists, and company legal policy updates. These tools will help make the business team the smartest ones in the room. It is important to ensure that the business team understands that the goal is to educate them in such a way as to help them negotiate the best possible deal for the company.

It is also helpful to make certain that the commercial side of the transaction appreciates the unique characteristics of franchising. Many do not, at least at the outset. It is often assumed that franchising is like any other business; as such, the limitations placed on this particular type of business are often unknown or misunderstood.

An effective way to get the point across is to draw an analogy between a franchise agreement and a lease. The concept of a lease is well-understood: an agreement is signed whereby one party purchases the right to use a piece of property or equipment for a fixed period of time. The property or equipment is utilized during the term to that party’s benefit, for which they pay a monthly fee. The property or equipment is returned at the end of the lease, at which point the lessee cannot recover any possible benefits or added value that may have accrued to the lessor by virtue of any of the lessee’s improvements. This concept also extends to a franchise agreement. A franchisee buys a right to use a trademark and/or a business system for a period of time during which a fee is paid for that use. The franchisee exploits the mark and system in order to obtain a return on the initial investment. At the end of the franchise agreement, the franchisee is in virtually the same position as the lessee at the conclusion of a lease: the trademark and the system are returned without expectation of payment. Once the commercial team understands this concept, it is much easier for them to negotiate and to provide reasoned responses to queries from a potential international franchise candidate.
C. Engaging Local Counsel

The structure or organization of legal support for a transaction may depend on whether or not the franchisor has in-house counsel and whether or not the cost of the transaction is paid out of the in-house lawyer's budget. The source of funding for the legal fees will often dictate the result. If the master franchise is part of a larger deal, such as the sale of an existing corporate foreign market, the necessary attorney fees should be built into the overall cost of the deal, taking the pressure off the legal department budget. That doesn't mean, however, that the in-house counsel has a blank check, or that the outside counsel can run amuck. The franchisor and its in-house counsel are always “budget-sensitive,” and the smart outside lawyer will keep that in mind. The in-house lawyer is looking for a combination of competency and efficiency from outside representation. If outside counsel exceeds the budget or its estimate on a consistent basis, clients will likely look elsewhere for legal representation.

Commercial businesses view budgets differently than the individual outside counsel who has received a “budget” for a project. The outside counsel may view the budget solely as the “wished for” result, so exceeding this budget may be of little consequence. For the in-house lawyer, on the other hand, keeping within the budget may mean the difference between receiving and not receiving a year-end bonus. Communication is key. In an international transaction, this sensitivity to budgets may take various forms. If the in-house lawyer has franchise expertise, the best way to minimize costs may be to keep most of the work in-house. Where in-house counsel is short on either time or franchise expertise, it may be wise to turn the entire deal over to the local counsel. The same will probably be the case for the franchisor without in-house counsel. A regularly scheduled call to assess progress and determine responsibility is essential. In-house counsel will want to know about reaching milestones or the possibility of exceeding the budget in advance of its occurrence. In-house counsel will also want to know why certain problems have arisen or, better yet, why they will or may arise. While unforeseen contingencies may elicit sympathy, avoidable problems will require the law firm to share the extra cost or bear it altogether.

Franchising has been around long enough that most outside franchise lawyers have some level of international experience or access to it in their firm or through their contacts in the legal community. As a result, many firms have developed country checklists that highlight the issues encountered in franchising in various countries. These lists are extremely helpful to franchisors and their in-house counsel. They help in-house counsel and outside counsel to prepare the negotiators for what would otherwise be traps for the unwary and could in some instances reveal a legal reality that makes the deal untenable, (e.g. agency laws that make it virtually impossible to recover one's trademarks upon termination or tax laws that make the financial arrangements wholly unattractive). Any assistance along these lines that outside counsel can provide will be very valuable and save an inordinate amount of time and money for all involved. In short, adding value through efficient and knowledgeable representation will both maximize efficiency and minimize risk and, hopefully, cost.

It is also important to ensure that outside counsel is appropriately briefed. The quality of legal input improves dramatically when outside counsel understands the entire transaction and overall commercial objectives. For this reason, it is helpful to have a telephone discussion at an early stage involving all parties – including outside counsel. If local counsel is engaged, they will frequently have local market intelligence that can be commercially valuable. A teleconference format also provides an opportunity to ask important questions and to ensure that there are no misunderstandings.
D. Respecting the Local Market

Franchising and franchise laws are well developed in the US, but this is not the case in all countries. American lawyers are accustomed to relative legal certainty, and the relative primacy of the contract. In other countries, however, contractual principles will be less clearly formed or will be regarded as less important than the personal relationship between the parties. Counsel often has to tread a fine line between protecting the company's interests and preserving the relationship.

Taking a hard line on every issue or having a strongly assertive approach may be part of the normal practice of domestic franchising, but on an international stage this may be counter-productive. Counsel may find that they need not only to justify their legal position, but also to explain clauses considered relatively standard in the U.S. There may be translation issues that require a simplified approach to documentation. Often concessions that have little justification on a purely legal basis have to be made to get the agreement completed. Although a detailed analysis of the art of international negotiation is beyond the scope of this paper, it is important to emphasize that counsel needs to respect the local market and the local participants to the negotiation, and be aware of local legal nuances and cultural issues in all international negotiations.

III. FRANCHISE STRUCTURE AND PRELIMINARY ISSUES

A. Overview

The structure chosen as part of an expansion strategy is a critical factor in determining the ultimate success of the venture. No single vehicle is ideal for all forms of international expansion; rather, the best structure will depend on factors such as the particular target market, the nature of the individual franchise business, the franchisor’s desired measure of control, the resources available for investment and, in some countries, local legal requirements. Unfortunately, expansion efforts are carried out frequently without properly addressing these and other important variables. Indeed, the discovery of a promising new market can often induce a hurried expansion process, in which the franchise structure is chosen without the benefit of adequate research and planning. In this scenario, the franchisor is “pulled” into a new market, instead of creating a plan to successfully “push” into that market.

When the appropriate measure of research and planning occurs, an informed expansion process will usually involve a choice among various franchise structures. Some form of direct franchising, master franchising, area development arrangements, area representative agreements, or some combination, as discussed below, can each be used to successfully “push” into most new markets. Occasionally one or more forms of expansion will be prohibited either by local franchise laws or foreign exchange legislation, or there will be particular reasons why one form of expansion is to be preferred. In this section, we provide an overview of the relevant business considerations the expanding franchisor uses to determine which of these structures should be adopted. In addition, we identify some of the critical issues that must be addressed at the planning stage of an expansion process, such as tax considerations, protecting intellectual property, and complying with local franchise laws.
B. Expansion Options

1. Direct Franchising

In a direct franchising arrangement, the franchisor contracts individually with single unit franchisees in the target market. This type of structure is used predominantly in domestic markets, and presents the franchisor with the best opportunity to retain maximum control over the business system. With greater control comes greater revenue: since there is no middleman between the franchisor and unit holders, royalties and revenue streams flow more freely to the top.

On the other hand, the need to establish agreements with individual unit holders usually results in a slower rate of growth. Single unit franchisees, who tend to be smaller and less sophisticated independent owner/operators generally require greater levels of support than would a more sophisticated multiple unit franchisee. This may also mean that the foreign franchisor will need to purchase or find local advice and contacts by itself, as well as establishing its own local distribution networks. Navigating the local market can be onerous and challenging under these conditions. Finally, under the direct franchise arrangement the franchisor generally provides all training, advertising and promotional materials. It may also be necessary to open a local office to support the network. As a result, direct franchising can be costly in both time and money.

These drawbacks have led to a growing view that direct franchising is not the most ideal model for international expansion. Under certain circumstances, however, it may be still be worth considering. For instance, a direct franchising arrangement can provide a way to test the target market before expanding through a different vehicle. Direct franchising may also be a sustainable method of expansion when the target market is located near the franchisor’s domestic market, or when there are few legal, linguistic and cultural barriers. Finally, this structure may be appropriate when the expanding system’s business is not very technical and little training will be required, where support can be provided effectively via the internet, or where a very high level of system control is indispensable to the franchisor.

2. Master Franchising

Master franchising is a popular expansion structure that avoids many of the drawbacks associated with direct franchising. Under this type of arrangement, the franchisor typically grants a master franchisee the right to grant subfranchises to subfranchisees. Depending on the size of the territory and the presence of any exclusivity provisions, the primary responsibility for developing the system in the new market may be transferred from the franchisor to the master franchisee. This means that the franchisor’s typical duties, such as establishing distribution networks and training programs, are devolved frequently upon the master franchisee. Consequently, fewer resources and significantly less capital investment are required of the franchisor under a master franchising agreement. This structure also takes advantage of the master franchisee’s familiarity with its own market. In this regard, the entire system can benefit from the knowledge and contacts of the local master franchisee, which can also help to ensure compliance with local laws. Master franchising also represents a lower risk strategy, in that the foreign franchisor will not be exposed to any local losses and will be relatively immune from any

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2 Slower is a relative term; growth rates in a direct franchising structure should still exceed the rates expected from opening individual corporate outlets.
form of damages claim or other legal liability in the local market. Another apparent attraction for some franchisors appears to be the lure of a substantial initial master franchise fee.

In spite of these advantages, however, the amount of delegation involved under a master franchise arrangement can be a double-edged sword. While the structure is useful for spreading the costs of administration, training and support, the existence of a master franchisee also decreases the franchisor’s control over the system. Consequently, the success of a master franchising arrangement depends ultimately on the abilities and acumen of the master franchisee as both a franchisee and a franchisor. It is therefore critically important to select a master franchisee with ample resources, sophistication and local knowledge. However, an ideal candidate with these characteristics will rarely be cheap or easy to find, so the selection process can be both time consuming and costly to the franchisor.

Ultimately, the level of growth attained by the master franchisee determines the success of a master franchising arrangement. As such, targets, incentives and penalties should be clearly established in order to facilitate maximum growth in the target market. In an ideal world, the franchisor might develop targets by testing the market through an initial direct franchise arrangement. This seems to happen quite rarely however, and the franchisor is left to study the market in other ways in order to determine the unit levels that should be attained. Master franchisees are very often required to own and operate one or more unit franchises themselves in order to familiarize themselves with the business. Success in operating a franchise unit, however, is no guarantee that the master franchisee will be successful as a franchisor. While the franchisor can teach a master franchisee how to operate a unit, it does not train the master franchisee in the business and art of being a franchisor. The master franchisee may not realize fully that it has contracted to run two businesses with the attendant time, human and financial resources required for both. When the day comes to sub-franchise, the master franchisee may find itself without the knowledge or expertise to do so successfully. It will need significant legal and other assistance to ensure compliance with local franchisee regulation, as well as the necessary management expertise to administer the chain in a proper fashion.

3. Area Development

Area development arrangements are similar to direct franchising, except that the franchisee is permitted to develop multiple units across a designated territory. This structure resembles direct franchising most closely - with all of its associated benefits and disadvantages - when the agreement covers a small developer or number of units. When the designated territory is large, the franchisor’s required capital investment is less with an area development structure than direct franchising, while also reducing administration costs, decreasing the need for training and monitoring, and requiring less direct franchisee contact. In addition, an area development structure allows for higher revenue and greater control than most master franchising arrangements.

As with master franchising, however, the success of an area development arrangement will ultimately turn on the quality of the area developer. It is therefore wise for the franchisor to begin by granting a small territory, with options for the area developer to acquire more territory as performance targets are met. The higher costs of initiating the expansion in this manner are offset by the reduced risk of depending upon an untested entity to develop the system in a large territory.
4. Joint Venture

In addition to the expansion methods described above, there are other options available to the expanding franchisor. One such alternative is a joint venture, in which the franchisor shares ownership of an operating entity with a local party. In practice, this type of arrangement does not change the franchise structure; rather, it allocates ownership and risk in a unique manner. A joint venture can be used to take advantage of the foreign partner’s local knowledge, and to gain business or tax advantages in markets where local businesses are accorded preferential treatment. This type of arrangement can also provide an additional source of capital. Because the franchisor is working on a more equal basis with the local party, it is possible to retain more control over the system than under a master franchise agreement. However, the franchisor will likely also have to assume more responsibility over the development of distribution networks and training programs due to this higher level of involvement, and large geographic distances always hinder a franchisor’s ability to maintain control.

An often heard complaint in this type of relationship, however, is that the franchisor joint venture partner does not know how to operate under the franchise business model. It tends to operate the units in the same manner it operates its corporate units (without sufficient regard for the fees imposed on a franchise business) as that is its experience and custom. The non-franchisor partner’s view is that such a manner of operation is harmful to the joint venture (and consequently the non-franchisor joint venture partner) while it benefits the franchisor joint venture partner in two ways – the franchisor joint venture partner collects fees as a franchisor and receives distributions as a joint venture partner.

The difficulties associated with joint ventures increase the farther the target market is from the franchisor’s domestic market. When the distance between the foreign franchisor and its investment is great, it is more difficult for the franchisor to be in charge of the day-to-day affairs of the business. As a result, much of the operational control of the business will, by necessity, be left to the joint venture partner.

5. Area Representatives

Another alternative may be to enter into an area representative arrangement, under which the franchisor grants rights to a local entity, allowing it to market, offer and perhaps even train and service franchisees on behalf of the franchisor. This represents more of an agency or broker arrangement than a franchise relationship, so if it is structured in a certain manner the expanding franchisor may be able to avoid the franchise disclosure laws of the target market. However, like single unit franchising, the franchisor will often be required to deal with unit franchisees directly despite the presence of the representative. Moreover, area representatives tend to invest less in the system than franchisees in either an area development or master franchising arrangement, and may be more likely to forgo their commitments. Thus, the risks associated with this type of arrangement may outweigh its benefits ultimately.

6. Hybrid Structures

While the analysis above addresses each form of expansion in isolation, it is just as likely that a transaction will take place in which two or more franchise structures will be included. For instance, it is not uncommon for a franchisor to permit the master franchisee to own and operate its own franchised units.
C. Preliminary Considerations

1. Trademark Protection

At its core, the grant of a business format franchise revolves around the use of “know-how” (the business system) and one or more trademarks. Accordingly, the expanding franchisor must be cognisant of the intellectual property laws that apply in the jurisdiction of interest. Protecting such marks in the target market is of the utmost importance if the expansion is going to be initiated. Franchisors must therefore address trademark issues early in the planning stage in order to ensure that their intellectual property is adequately protected.

Trademark registration provides both maximum legal protection and the greatest potential for the mark to increase in value. The registration of a trademark in the domestic jurisdiction may also serve as a starting point for protection in a foreign country. However, it is necessary for the expanding franchisor to identify quickly the registration requirements of the target jurisdiction. In particular, the franchisor must ascertain whether the target jurisdiction registers trademarks on a “first-to-file” or “first-to-use” basis. Difficulties may arise for a franchisor that wishes to register a mark in one of the first-to-file countries, such as China and many of the Gulf States, because applications filed by third parties for speculative purposes will be given priority even if the franchisor has made exclusive use of the mark. To avoid this type of setback, franchisors should file for trademark registration in the target market at the earliest opportunity.

Cases abound where a planned expansion has been stopped entirely on the basis that a trademark has been applied for or registered by someone else in the target market. Other times the franchisor’s first order of activity is to spend time and money to get back a trademark that a third party has already applied for or registered in that new market.

2. Tax Issues

The methods of expansion described above each have different tax implications. While foreign tax laws will vary depending on the particular target market, it is always important to determine at the outset whether the franchisor will remain a foreign entity (and whether it needs to then qualify to do business in the local country) or be a domestic entity, such as through a local subsidiary or a joint venture. The expanding franchisor must also consider the nature of any payments being made, and how taxes will affect revenue streams at both the target level and the home level. It is also very important for the franchisor to be conscious of foreign tax laws, as it may be possible to use special purpose entities in order to reduce tax liability. Finally, it is crucial to identify withholding tax obligations, and any treaties that may affect withholding taxes.

3. Franchise Law Compliance

Local laws in the target market may restrict the use of some structures, and may encourage the adoption of others. In China, for instance, master franchising is not permitted. On the other hand, creating a joint venture can allow the franchisor to circumvent onerous local ownership requirements in certain jurisdictions. It is therefore important for the franchisor to identify the potential legal limits of the expansion effort, and to determine the consequences of non-compliance with local franchise regulation. It is also wise to anticipate the administrative red-tape in many of the less commercially-focused markets. Finally, the disclosure laws in some jurisdictions can require an enormous amount of paperwork when they impact area development or master franchise arrangements. In short, the emerging body of franchise law in many jurisdictions emphasizes the need to plan carefully an expansion effort. Without sufficient
preparation, an expansion effort can be compromised by a minefield of potential legal issues in the target market.

4. Decisions Based on the Target Market

The form of franchise development can also depend on the market, its geographic location, language, cultural similarities to the home of the franchisor, and relative acceptance of the structure. In Continental Europe a master franchise arrangement appears to be less appealing to local parties than it would be in the United Kingdom. In Asia, joint ventures are more common, although master franchising to larger corporations is also popular. In Australia and New Zealand market entry via master franchising would be the most common form of international expansion. However a substantial number of successful systems have in fact used direct entry, sometimes with a local party in a form of area development role. In Canada, although accurate statistics are unavailable, there appears to be less and less direct franchising from U.S. based franchisors. The current trend suggests that direct franchising is being replaced by structures that depend more on sophisticated local parties, such as master franchisees, area developers and area representatives.

IV. NEGOTIATING CONTRACTUAL TERMS

A. Overview

This part of the paper focuses on issues that are typically the subject of negotiation between parties to a franchise expansion. In pursuing this focus, we tackle issues from the perspective of the attorneys representing the expanding franchisor, as they typically draft the contracts. However, each situation raises a unique set of issues, and the appropriate solutions will depend on the particular circumstances. So, our analysis aims to provide insight into the commercial and legal issues that arise frequently in the context of a franchise expansion. In addition, we provide and discuss sample contractual provisions that have proven successful in our experience as franchise lawyers.3

Our analysis proceeds on the basis of certain key assumptions. It is assumed, for instance, that the parties have the shared intention of optimizing the growth, development and success of the business in the territory. It is also assumed, for the sake of simplicity, that the parties have agreed that a master franchise format best suits their respective requirements, although many of our comments apply equally to other franchise structures. It is further assumed that all relevant tax and foreign investment advice has been provided and any requirements for registration or disclosure under local franchise laws have been, or will be met. To the extent necessary it is also assumed that all due diligence has been completed. Finally, this paper assumes that the negotiations involve willing but not anxious parties, who are prepared to compromise in circumstances where the risk is commercially acceptable, and their rights are not prejudiced in a material way.

It is nearly impossible to separate the legal and commercial issues that arise in an international expansion; indeed, the franchisor will expect generally that its attorneys provide significant input into the commercial discussions. Although local counsel will not be expected to provide input

3 These provisions are intended to be illustrative, and should be considered carefully before being used as precedents.
into whether the concept will appeal to customers in the market, local counsel will often be expected to provide input as to typical industry practice concerning issues such as fee structures, territory development, structure and risk. It is by necessity, therefore, that our analysis extends to both the legal and commercial aspects of an international franchise expansion.

B. Parties to the Contract

Franchising is essentially a contractual relationship, where the agreement between the parties determines their respective rights and obligations. The general principles of privity of contract apply. Accordingly the first step in drafting any international franchise agreement is to identify correctly the appropriate contracting parties from both the franchisor and franchisee perspective.

First, the franchisor needs to determine the identity of the franchisor in the new market. For various reasons, the franchisor may or may not wish to use the entity that has acted as franchisor in its domestic market. For instance, the tax laws of either the United States, assuming it is the home country of the franchisor, and the tax laws of the target country need to be considered carefully in each transaction. That is particularly true of the first transaction involving a target country.

While it is beyond the scope of this paper to discuss all possible combinations and permutations, it is important to note that the franchise lawyer needs to recognize the issue, and advise their client to obtain competent tax advice in both jurisdictions. For instance, the use of a limited liability company (an “LLC”) as the franchisor domestically is becoming very common in the United States. However, as between Canada and the United States, the use of an LLC as the franchisor into Canada is problematic as that type of entity receives no relief under the Canada-U.S. Tax Treaty from the withholding tax obligations under Canadian tax law. So, while using an “S. Corp.” as the cross border franchisor results in a withholding tax rate of 10% percent of the amounts being paid, using an LLC results in a 25% withholding tax rate. In some instances it is likely a benefit for the franchisor to set up a wholly owned subsidiary entity under the laws of the target jurisdiction, while in others that may be the last thing a franchisor should want to do.

A second major issue that must be considered is the extent of the local franchisor’s liability. Most foreign companies entering the United States to do business would view use of a new business entity as mandatory, in light of the well accepted view that a business operating in the United States faces a greater litigation risk than anywhere else in the world. Nevertheless, U.S. companies entering a new foreign market may wish to isolate their potential liability by setting up a new U.S. or foreign entity to be the franchisor in the market. Avoiding the application of a foreign franchise law in regard to the domestic U.S. franchisor could be one such motivation.

In many cases, the long term intentions of the franchisor are important. Does it intend to be active and have a presence in the foreign market? Decisions concerning training, support, site selection and construction management will all contribute to the franchisor’s involvement in the foreign market. If any of these decisions encourage the franchisor to set up and maintain employees or a local office, the franchisor may be subjected to local tax laws and other forms of regulation.

In some cases, the franchisor, master franchisee and the ultimate sub-franchise are all parties to the unit level franchise agreement. This often provides the franchisor with greater control over
what goes on at the unit level. However, the franchisor then has direct privity of contract with the sub-franchisee, and potential liability is expanded. The franchisor may also subject itself to franchise law application at the unit level, which is something that is often best avoided.

It is also important for the franchisor to take precautionary steps when dealing with a corporate franchisee. In many cases, the local franchisee will elect to establish a corporate entity to hold the master or development rights. The corporate shareholder(s) in this type of arrangement will not be personally liable for any of the debts or obligations associated with the agreement. When the corporation has been set up primarily for tax benefits to the local single unit franchisee, it is highly unlikely that the corporate entity will retain sufficient capital or assets to satisfy its debts or other obligations in the event of financial hardship. It is therefore important for the franchisor to protect its interests as creditor to the corporate franchisee.

There are several ways to go about this. One option is to obtain a personal guarantee from the individual shareholder(s) or corporate parents of the corporate franchisee. If a guarantee from the controlling shareholders can be included in the franchise agreement, the franchisor can minimize the risks associated in contracting with a separate corporate entity.

While obtaining a guarantee is expected when the transaction involves the grant of a single unit franchise (or even a small multiple unit transaction), the situation can be much different when the contract is either a master franchise or large scale area development agreement. In these instances, the party to whom the rights are being granted is often much larger and more sophisticated, and could already have extensive business holdings. Obtaining a personal or even corporate guarantee may therefore be out of the question, and other forms of security need to be considered. In the absence of an appropriate security arrangement, the franchisor needs to consider if it is worthwhile to proceed. This is even the case where the sophisticated master franchise candidate plans to incorporate a new company to hold the master franchise rights. In those situations, the master typically will take the position that its often significant investment in launching the franchisor’s business in the new territory, coupled perhaps with other non-guarantee type security, must suffice.

If security is to be obtained from corporate or individual owners of a corporate franchisee, then this is coupled typically with including those guarantors as parties to an indemnity in favor of the franchisor. In some jurisdictions, guarantees have the potential to be more complex and difficult to enforce, so indemnity clauses often present the franchisor with a viable alternative.

In many instances, the franchisor will not view these as adequate, and the franchisor may then also insist on additional forms of security, such as by requiring bank guarantees or letters of credit. These may be required upon execution of the agreement or at a later time such as upon the occurrence of a monetary default as part of the cure.

It has also become increasingly common for franchisors to insist upon the grant of a security interest by each of their single unit franchisees. Negotiating a security interest can provide an effective risk management tool for the franchisor whether it is contracting with an individual or a corporate entity, as the franchisor’s status as an unsecured creditor is always precarious if the franchisee becomes insolvent. The benefits need to be tempered by the reality that the franchisor will need to administer the registration of these security interests under the applicable personal property security regime (the Uniform Commercial Code in the United States), and invariably will need to postpone its interests to those of the franchisee’s primary lender(s). Still, taking a security interest can be very beneficial to the franchisor in the event of a default by a
franchisee and competing claims by a bank, landlord, the franchisor, and perhaps even the local government.

Care needs to be taken in regard to the form of security agreement to be used. The personal property regimes of most jurisdictions are unique, and it is a matter that typically falls under the category of “local law considerations”. Accordingly, a U.S. franchisor should not expect to be able to use the same security agreement it may use in the United States, and should instead expect this document to be sourced from local counsel. Obtaining a security interest is not the only reason to consider adding parties other than the master franchisee to the agreement, or contracting with them separately. Enforcement of internal and post-term restraints and confidentiality obligations may make it important to add other parties. It is also common to include covenants as to the involvement of certain key individuals in the business. The covenants are often included even where the individuals do not guarantee the financial obligations of the master franchisee.

C. Granting and Reserving Franchise Rights

The rights granted through the franchise agreement are of course fundamental aspects of the contract, and can vary greatly depending on whether the contract is for a single unit franchise, area development rights, master franchise rights, or some combination. As noted above, area development arrangements revolve around the right and opportunity to become a single unit franchisee multiple times in a territory of some identifiable size. In contrast, master franchise agreements revolve around the right to become the franchisor for an identified territory, and subfranchise single unit franchises. With these important differences in mind, it is also important to point out that many agreements permit the recipient of rights to either open units or subfranchise, or both.

The various contractual provisions that define the relationship between the franchisor and franchisee are based upon the fundamental rights that are granted at the outset. A master franchise agreement, in its most common form, is often longer and more complicated due to the nature of the responsibilities thrust upon the master franchisee. In its simplest sense, an area development agreement can be an agreement to sign a multitude of single unit franchise agreements at some future time.

Unlike the single unit franchise agreement, the grant of larger area development or master franchise rights is less often done by way of a form of agreement that is in a standard form. Some of the largest franchisors, and in particular those with a history of international franchising, could have a carefully considered “international program”, with a chosen structure and standard form documents. Just as often the lawyer encounters the franchisor embarking on their first international foray, and the structure, plan and form of documents are to be determined as part of negotiating this first transaction. In either case, the amount of negotiation will depend on the size and importance of the transaction. The large transaction will be subject to significant negotiation while the smaller ones will have less negotiation simply by virtue of the fact that the deal is of lesser importance to the franchisor, who will be less willing to change whatever terms and conditions have been chosen as “standard”.

In a non-exclusive arrangement, the franchisor retains the freedom to pursue further expansion within the designated territory. An exclusive arrangement, on the other hand, will prohibit the franchisor from competing with the franchisee within the defined territory. Generally speaking, these types of provisions are designed to insulate the master franchisee or area developer from competition with other units of the same franchise.
When single unit franchises are being granted, fewer large franchisors are offering territorial exclusivity as part of what is being offered. Where, however, the subject matter of the contract is a large scale master franchise, or area development rights, most often the recipient is contracting for some form of exclusivity. This may appear to counter recent trends in the marketplace. However, counsel needs to remember that the area developer/master franchisee will be invariably bound to development schedules with firm requirements in terms of the number of units that need to be opened or subfranchised in the territory during a specified period of time. The failure to meet these targets is viewed usually as a serious default, which can result in termination, or at the very least, the loss of exclusivity in the territory. Due to the seriousness of this default, a great deal of care must be taken when setting targets as it is risky business when neither the franchisor nor master franchisee has any true understanding of whether the concept will translate to the new country in the same manner in which it is implemented domestically.

Within the last ten years or so, these contracts have become ever more sophisticated in terms of what is granted and what is not granted, and thereby reserved. Invariably, the franchisor’s granting provisions will also include the explicit reservation of certain rights. These provisions can ensure that the franchisor does not contract itself out of future business opportunities in the new market. Typically these provisions will anticipate the possibility of the corporate franchisor merging with, acquiring or being acquired by another company, or otherwise developing potentially profitable business relationships in the target market. The rights reserved most often relate to the different channels by which the franchisor’s products and/or services reach the ultimate consumer. In this electronic age, and with consumers demanding broader access to goods and services, the opportunities available are more numerous than ever before.

Accordingly, the sale at retail by way of mail order and the internet, the opportunities to place retail outlets in non-traditional locations, and the availability of alternate means of distribution through supermarkets or other locations, vending machines, corporate groups, and even to clients who do not wish to purchase from franchisees, all mean that the grant of rights by the franchisor, and the reservation of certain rights at the same time, has become a very complicated exercise in the drafting and negotiation of any type of franchise agreement. This is true for the lawyer drafting a standard form unit franchise agreement package, as well as for the parties negotiating a master franchise agreement for an entire country.

How the reservation of rights issue is resolved most often depends on the bargaining strength of the parties to the transaction, and, just as importantly, the measure of actual involvement the franchisor plans or should expect to have in the international territory. For instance, if the franchisor does not intend to sell its products into the territory over the internet, why then does it need to retain those rights? Permitting the master franchisee to pursue that opportunity could very well mean the franchisor derives revenue from a source that would otherwise remain unexploited. On the other hand a master franchise agreement is usually a long-term contract; management’s intentions can change, and rights not presently needed by the master should be reserved. As a compromise, a master franchisee can be given the first right of refusal over new channels or business opportunities.

Each of the foregoing issues is addressed in the sample clauses produced in Appendix A.
A franchise expansion can produce an extensive and complex contractual relationship. Of the numerous contractual terms to be negotiated, however, none may be more important than the fee structure established between the parties. From the perspective of the franchisor, all of the potential costs of international expansion must be anticipated and accounted for when the terms of payment are negotiated. For instance, all of the costs to the franchisor associated with opening additional units, training, advertising, other oversight, and a profit, must be incorporated into the agreement in order to ensure that the expansion is a financial success.

Franchise fees vary widely in both purpose and measure. In a master franchise agreement, for example, it is common for the franchisor to levy considerable up-front fees for the execution of the agreement and future management services. This allows the franchisor to implement its expansion strategy while leaving much of the capital investment to the local master franchisee. On a long-term basis, additional revenue streams flow to the franchisor through royalties and additional unit fees, which, when structured properly, can also provide growth and performance incentives to the local master franchisee.

The question franchisors new to international expansion most often pose to experienced counsel relates to the amount that can be charged as an up-front master franchise fee. Unfortunately, there appears to be no hard and fast rule, and the prices appear to be set by market forces. While common sense would suggest that stronger and better-known brand names can command the largest sums, systems involving the latest “fad” - even if unproven – can often involve an equal or even greater upfront franchise fee. Using experienced local counsel can sometimes assist: if they are knowledgeable, then they may have access to examples from transactions they have been involved in the past that relate to that market.

The local party will often oppose the prospect of paying a large initial fee – particularly if the local party feels that the concept is unproven in the local market, or that the franchisor is not genuinely committed to the local market. The obvious worry of the local party is that a disinterested franchisor will not provide the necessary support after the initial fee is paid. This is a matter for negotiation. As a compromise, the parties may consider allowing for the initial fee to be paid in instalments over a period of years.

There are also a variety of methods by which other payments under the typical contract may be dealt with and split. For both the franchisor and master franchisee to thrive, each will require a share of the unit franchisee’s payments. Most franchise systems involve a royalty based on a percentage of the franchisee’s gross sales. However, this type of arrangement raises its own set of questions. What is the appropriate amount to be taken by the master franchisee, and what percentage or even flat rate amount should be paid to the franchisor? Does it matter whether or not the master franchisee in fact collects those monies from the franchisees, or are they payable to the franchisor regardless of if they are ever collected from the franchisees? Should there be an additional fee charged per outlet opened?

The scientific approach to these questions should involve an analysis of the franchisor’s and the master franchisee’s respective tasks. The person bearing the greater responsibility, and hence the costs and potential for liability, should be paid more. If the franchisor provides training and the local party receives initial fees from sub-franchisees, it would be customary for the franchisor to obtain a share of these fees. Whether the transactions all work out that way is likely another story. It would not be uncommon for the parties to agree to split all fees equally, regardless of the particular division of labor. Where the franchisor provides little in the way of
hands-on assistance, the franchisor’s share of the royalty may justifiably be lower than 50 percent of the amounts paid.

A somewhat different analysis arises in relation to advertising fees to be paid by franchisees. Does the franchisor intend to create and operate an advertising fund in the territory, or is responsibility for the operation of an advertising fund to be delegated to the local person in charge of the brand, namely the master franchisee? The resolution of this business issue should lead to a determination of where the advertising fees are to be paid. Of course, sometimes amounts are split, such as where the franchisor is still responsible for development of the advertising creative content, which it then permits the master franchisee and local franchisees use of in the international market.

Although a comprehensive fee structure can be successfully negotiated and implemented into a franchise agreement, there are thorny tax issues associated with cross border fee payments that should be dealt with in separate contractual provisions. In particular, steps must be taken to ensure that the agreement complies with any non-resident withholding tax provisions that govern the foreign jurisdiction. Interpreting the tax provisions of one’s own jurisdiction can be tricky enough; having to contend with the tax laws of another country adds yet another layer of complexity to the international expansion process. Nevertheless, an effective and legally valid fee structure must be consistent with the tax laws of both the domestic and foreign jurisdictions.

It is also important to identify any international tax treaties that may affect the tax liability of a non-resident franchisor. For instance, the Canada - U.S. Tax Treaty reduces the withholding taxes on fees, dividends, and interest paid to U.S. resident franchisors. While the normal withholding tax rate on the royalty for use of intellectual property is 25% of the amount paid, the Treaty reduces this figure to 10% of the amount paid. However, the Treaty does not reduce these payments if they are made to an LLC. So, while these entities are used quite commonly in the United States by American franchisors, they pose challenges for an international transaction. Many such international tax treaties exist, and must be identified early in the negotiation process so that an appropriate fee structure can be established.

A more vexing issue in relation to the issue of withholding taxes is the practice of U.S.-based franchisors imposing a “gross-up” on their foreign franchisees. This means that the franchisor requires that the master franchisee add to their payments an amount equal to the withholding tax so that the franchisor in fact receives the original amount contemplated under the contract without deduction. This requires that the person paying must pay more than the contract rate, since the statutory tax amount must still be withheld. The troublesome issue for most master franchisees is that the tax withheld is the franchisor’s tax payable in that jurisdiction, and that the amount withheld can result in a credit to the franchisor on the taxes payable in their domestic jurisdiction. If gross-up arrangements are intended to apply, this issue should be addressed early on in the negotiations. When raised later in negotiations, a gross-up has the potential to be seen as a change to the underlying deal or even a demonstration of bad faith.

In addition to tax considerations, the fee provisions of an international franchise agreement should also deal with the issues of currency and conversion. From the franchisor's perspective, the goals are to avoid the potential dangers of an increasingly volatile international currency market, ambiguities with respect to the currency of payments and the responsibility for conversion of funds. Most often the franchisor will insist that payments be made in the currency of its home market, and that the master franchisee bear the responsibility and risk of converting funds originally generated in local currency.
More complicated issues arise when there is a perceived risk that funds cannot by local law be repatriated to the franchisor’s home market. This can often be an event of default that leads to termination. Circumstances may require that the franchisor become creative in its efforts to repatriate funds. Examples include options such as:

(i) requiring that guarantors who have accounts outside the local country make payment of delinquent amounts under their guarantees from funds outside the country leaving the guarantor to recover amounts paid from the franchise entity within the country;

(ii) accepting the master franchisee’s or guarantors’ other assets, such as real property located inside or outside the local country;

(iii) providing payment in a currency different from that specified in the agreement, e.g., pounds sterling instead of US dollars; or

(iv) accepting payment through a barter or through third party services, e.g., accepting travel vouchers or airline tickets purchased in the amount of fees owed.

The issues highlighted in the foregoing analysis are addressed in sample provisions provided in Appendices B and C.

E. Term and Renewal

The negotiated term of the agreement will establish how long the master franchisee retains the rights to develop sub-franchises and operate as sub-franchisor in the target marketplace. As the master franchisee is often building an infrastructure in the new market, and granting sub-franchises with their own long terms attached, it is not unusual for the term of a master franchise agreement to extend for a long period of time. This can range anywhere from 10 to even 99 years. With renewal rights, the term could become effectively perpetual. The development obligations or rights under the master franchise agreement generally expire, leaving the master franchisee with management obligations that continue until the last subfranchise expires.

In contrast, the typical area development agreement term tends to be quite short. Recall that at its core, the area development agreement is an agreement to sign many individual franchise agreements over a fixed period of time. The individual franchise agreements are the agreements that provide the developer with longevity, typically by providing a term that is similar to the term of a typical unit franchise agreement in the United States, such as 10 to 20 years. With the area development agreement setting the developer’s development obligations, it would not be uncommon for the length of that agreement to be relatively short, with common agreements being between 2 to 5 years.

Further, renewal of the area development agreement is not a provision that should be taken for granted. Unless the market can then support additional unit franchises, there is no point in including an additional development term. Even if such renewal provisions are to appear in the contract, determination of the additional development obligations will often then need to be agreed upon, rendering the developer’s right to renew into no more than an “agreement to agree” and a statement of the parties’ intentions only. These types of provisions are often in this form so as to encourage efficiency and growth in the new market, while providing the franchisor with an exit strategy if the franchisee’s performance does not live up to expectations.
When it comes to establishing renewal conditions, for most franchisors the starting point is the list of conditions that typically are found in a single unit franchise agreement. These usually include such provisions as a requirement that the franchisor avoid default during the term, that a release be signed in favor of the franchisor, and that a renewal or other fee be paid. The most contentious condition is often whether the master franchisee/developer must sign the “then-current form” of master franchise or development agreement, with then-current financial terms.

Once again the size and sophistication of the parties will determine the renewal conditions that are negotiated, and the areas of compromise between the parties. Purely legal issues are often left in, with more business oriented provisions often subject to negotiation. It would not be uncommon for the sophisticated large master franchisee to obtain the right to have the same form of agreement apply on renewal.

Sample term and renewal provisions are provided in Appendix D.

F. Performance Criteria

1. Business Negotiations

International franchising is not about putting flags on a world map, it is about creating a global brand and business format that is successful in every country in which it operates. As with domestic franchising, international franchising should not focus upon granting master franchises, pocketing a large initial fee and moving on to the next country. Rather, the key is to create a local network that fits within the global brand requirements and contributes the optimum flow of recurrent revenue from the local master franchisee to the international franchisor.

A franchisor will wish to establish a framework that ensures the local candidate can be held accountable for growth and development within the territory. In simple terms, the franchisor will wish to see the territory developed as quickly as possible so that net revenue to the franchisor from the territory is maximized in the shortest possible time.

Probably the most important, and therefore often the most contentious, clauses in international agreements relate to territory development. The franchisor will wish to set clear and unambiguous criteria so that the local party can be held accountable for performance in the territory. The local party will share the vision, but be less inclined to commit to specific criteria. The usual compromise is a set of agreed and fairly conservative objective criteria included in a territory development schedule attached to the international master franchise agreement. In simple terms, normally it will provide for one or more of the following:

1. The number of new outlets or units to be established for each year during the term of the agreement;

2. The total number of units required to be open and operating during each year of the agreement. (This requirement is of course necessary to ensure not only that units are opened, but that they remain in operation generating revenue.)

3. The total gross sales from all units in the territory.

A sample territory development table is included in Appendix E.
As mentioned above, the standard franchise agreement will typically be a long term agreement. As such, the commercial challenge is to assess the territory’s potential in terms of the ultimate number of units that realistically can be achieved, likely sales for each unit and realistic speed of development for the concept within the territory. This can be a very difficult challenge, and negotiations can be protracted.

The franchisor and the local party will typically bring different sets of experiences to the negotiation process. The franchisor will have a comprehensive understanding of the business and will be able to visualize, at least theoretically, the extent of local market success based on extrapolations from its domestic success. However the franchisor may be in a position of some market strength and power in its home market, whereas the local party will be a new entrant to the market.

The local party, on the other hand, will have an understanding of the local market conditions and the extent of existing competition, but may not share the optimism of the franchisor. There is no substitute, however, for sufficient due diligence in the target country. Neither the franchisor’s experience domestically and optimism for the local market nor the local party’s enthusiasm or lack thereof for the franchisor’s plan is the true test for the market. In many instances there is too much optimism at the outset about the potential of the market and as a result the parties do not perform sufficient due diligence to test the market on an adequate basis.

The negotiation process can be improved if one party or the other conducts detailed market research to ascertain the true market potential and to benchmark product pricing, competitor activity, establishment costs, operating expenses, growth margins and other factors relevant to the operation of the business in the territory. Unfortunately this rarely occurs. As a consequence the territory development negotiations can be difficult, particularly if the consequences of failure to meet the territory development criteria revolve fundamentally around termination.

Negotiations also need address the likelihood of a master franchisee achieving the same level of success that the franchisor has achieved in its home market. This is of particular importance if the local party does not have substantial business experience in the relevant segment. The determination of realistic territory development criteria needs to factor into the calculations the capital, resources and relevant experiences of the local party, and temper any projections of market potential with reality.

Local parties frequently underachieve against even conservatively established territory development criteria -- mainly because the extent of time and capital required to establish the initial units is often underestimated. Other intangibles, such as the time required to validate the concept in the market and absorb initial working capital losses that occur in most businesses that start from a zero base, also tend to be inaccurately gauged. In practice, the foreign franchisor’s choice of local party is likely to be a suitable - but not perfect - candidate. In other words, the local party will have deficiencies either in terms of inadequate capital to fund sufficient initial outlets, or initial working capital to ensure optimum growth and development. There may also be a lack of operational skills that will prevent the local party from operating or teaching others to operate individual units as profitably as they are run in the home country.

In addition, there is often a failure to recognize that the master franchisee is being asked to actually undertake two new businesses at the same time: the operation of a chain of units, and the franchising of units themselves. Since the master franchisee rarely is trained in the business
of sub-franchising, estimates of the time and resources necessary to operate successfully are often inaccurate.

2. Drafting Performance Clauses

Once the parties have agreed on the territory development and other performance criteria, the relevant schedule and clauses need to be inserted into the agreement. Typically there should be a schedule setting out the agreed minimum number of units that need to be established in the territory in each year of the agreement. Some additional provisions may also need to be inserted in the body of the agreement to ensure that the obligations are clear, enforceable and not easily circumvented by an under-performing master franchisee.

It is often wise to address the following types of issues in the agreement.

(i) The definition of a “unit”, so that it is not open to abuse. Underlying the franchisor’s agreement to a unit is an expectation that a unit will generate a certain amount of gross revenue, and therefore royalties and other gross revenue based income to the franchisor. Unless more accurately defined, a “unit” or “outlet” will mean only an individual business establishment. This definition may be inadequate, and may allow a master franchisee to open units without achieving optimum territory penetration. For a franchise selling products, a retail store will constitute a unit, but so might a small supplementary kiosk in a shopping center, a mobile cart used to service occasional special events, a concession at a movie theater or even a single refrigerator or cabinet in a convenience store. It may therefore be necessary to define ‘unit’ more precisely, which may include establishing a minimum threshold for generating revenue in order for such a unit to count in the calculations.

(ii) From time to time it will be necessary to close units. The agreement needs to consider the likelihood of closures provided that units closed are deducted from total units and account for any reduction in gross revenue generated by a unit which impacts on the franchisor. For example, the franchisor may need to consider whether a unit in a holiday location that is open only for certain months of the year qualifies for the unit development criteria calculations.

(iii) As the unit criteria are often measured at a particular point in time, it is necessary to ensure that the calculations cannot be affected by a flurry of openings at the time of the calculation. It may be necessary to provide that a unit must be open and operating for at least 3 months to be included in the calculations, or alternatively that certain criteria (such as the existence of a long- term lease, and the commencement of operations at the premises) need to be satisfied before the unit is counted.

Different commercial arrangements will have different requirements, so it is not possible to simply suggest a precedent clause to be universally adopted. The franchisor’s attorney needs to be mindful of the interaction between these issues and the calculation of other fees due to the international franchisor. If, for example, the franchisor receives a significant fee on opening any new outlet or unit, this may be seen as a sufficient deterrent to the master franchisee abusing the calculations. On the other hand, if the franchisor is dependent almost entirely on a royalty that is a percentage of sales within the territory, the franchisor’s attorney will need to be more vigilant in this area.

The sample clauses produced in Appendix E illustrate some of these issues and outline how clauses can be drafted to address them.
3. **Minimum Gross Territory Sales**

A franchisor will often receive a fee on signing the international master franchise agreement, in addition to ongoing fees per outlet opened and as a percentage of gross revenue in the territory. In the long term, the franchisor’s profitability in the territory will be dependent upon the ongoing revenue stream. It is therefore prudent to have some territory development criteria that relate to minimum gross territory sales. The local party may also prefer this arrangement. Where once franchise chains generally featured only one store or unit format, today there are frequently multiple formats within the network. In a retail food network, for instance, there may be a kiosk or mobile element to the business in addition to the standard single premises. It is recommended that the parties establish a territory development schedule that does not encourage the local party to open more outlets when it may be more profitable for all concerned to have fewer larger outlets.

The extent to which the franchisor’s lawyer becomes involved with the commercial negotiations will depend upon a number of factors including the experience of the client, the experience of the attorney, the preferences of the respective parties and probable cost. However, it is critical that the attorney understand the commercial objectives of the franchisor and turn his or her mind to any refinements to any agreed territory development numbers to ensure that they true intent of the franchisor is not frustrated.

By setting minimum gross territory sales as additional development criteria, the franchisor will be protected against the abuse of unit numbers, and will also be provided with an additional mechanism for evaluating the performance of the local party.

4. **Other Performance Criteria**

While sales and development are of central importance to the franchisor, there are other ways to measure performance in the foreign market. For instance, it is important for the brand to be appropriately built and positioned in the market in a manner that is globally consistent. Local adaptations will often be required for numerous reasons, but the international franchise agreement needs to contain mechanisms to ensure that the brand is protected, and that adequate resources are actually devoted to brand development. If the brand is not built such that consumers identify with it, a franchisor’s system will be vulnerable in those international markets. There have been several instances where franchisors have developed a business format within a foreign territory only to find that after a dispute with a local party, the whole network is re-branded and the franchisor is, at best, left pursuing a local damages claim. At worst, the franchisor will have invested substantial time, effort and intellectual property in helping to develop the local market for the ultimate benefit of third parties.

As outlined in other parts of this paper, it is of fundamental importance for the franchisor to ensure that its intellectual property is protected. However, it is also necessary for there to be sufficient investment in building the brand associated with that intellectual property, as it is upon the value in the brand that the security of the franchisor’s revenue stream is ultimately built. It is also appropriate to build in additional protection for the franchisor such that the integrity of the intellectual property can be protected throughout the term of the franchise agreement and upon termination. It is important, therefore, to include clauses prohibiting competition in any form by either the local party or any associated entity during the term of the agreement or for a reasonable period after expiration or termination. It may also be necessary to reinforce that protection by seeking personal covenants from individuals who might otherwise be capable of transporting intellectual property for the benefit of a third party or even themselves. Similarly,
the local party needs to be discouraged from making available any confidential information to any third party. This may require careful consideration of employment contracts of the local party to ensure that there is adequate protection to the franchisor and indeed the ability of the franchisor to take direct legal action if required.

As discussed above, the most common territory development criteria are objective criteria relating to minimum units and minimum gross sales. However, it will often be appropriate to consider including other criteria. This can include specific commitments to the annual expenditure on brand building through approved advertising and other means in the territory. If it is important that the local party support, service and supervise a local network of sub-franchisees, it may be sensible to include specific requirements in relation to sub-franchisee satisfaction and performance. These criteria may be more subjective, although with careful thought it is often possible to develop objective measures as well, such as the number of specific activities or even percentage satisfaction as per an annual sub-franchisee survey.

5. Default in Meeting Targets

The outcome of the negotiations between the parties concerning territory development criteria is usually a compromise. Although the extent of the compromise will depend upon the sanctions applicable in the event of failure to meet the criteria, it is probably fair to say that the criteria themselves will be a fairly conservative prediction of future growth and development.

As both parties are likely aware of the inherent difficulties in predicting territory development, there sometimes tends to be commercial flexibility once the local operations are up and running. In a domestic franchise context, there is typically less focus on alternative remedies to termination. Not only is the franchisor more happy to have termination as a sanction and indeed act upon it, but the franchisor often has the resources to step in and manage any operation even if the agreement relates to a reasonably large area development arrangement. That is rarely the case internationally. In most instances the franchisor will not be interested in entering the market itself, so the franchisor’s attorney needs to be more inventive in terms of alternative remedies.

One of the problems with enforcement is the reticence of the franchisor to enter the local market. As a result, the franchisor may tolerate endemic non-performance, as the alternative – market entry and running the business itself – is far less palatable. This is particularly the case if a master franchisee has been appointed, and that master franchisee has appointed sub-franchisees in the market.

There are other alternatives to termination that merit consideration, including the following:

(i) Liquidated damages clauses that require the local party to pay a specified amount if the territory development criteria are not met. These clauses can be a powerful supplementary control mechanism, particularly if the territory development criteria are justifiable and the local party is of financial substance. The liquidated damages need to be a genuine pre-estimate of damages, as opposed to pecuniary penalties, as otherwise they may not be enforceable.

(ii) Clauses providing for potential loss of exclusivity, so that the franchisor can serve a notice that the local party is no longer the exclusive representative of the franchisor in the territory. These clauses are useful if there is some concern as to the capacity of the local party to fund network expansion, or that the territory granted is too large.
(iii) Demotion clauses that enable the franchisor to demote the local party to unit franchisee status, as opposed to being the master franchisee. The clause should also include a requirement for the local party to accept that it will be accountable to any new local master franchisee or person given responsibility for overall territory development. This remedy is particularly useful where the local party is operating one or more outlets reasonably successfully, but has not been able to expand throughout the territory due to under capitalization, lack of resources or simply lack of business capacity;

(iv) Mandated sale, such that the local party is required to sell the business to another party within a specific timeframe. This requirement is useful where other remedies would not be viable, or where the local business is quite saleable and other suitable candidates would exist to purchase the business.

A franchisor may also wish to require that the local party undertake additional training, raise additional capital, implement certain systems or managerial change (such as removing or changing the senior management), or otherwise undertake specific improvements to the manner of operation of the business in the local market. It will generally be quite difficult to predict what will be necessary, and therefore it will be not possible to build the agreement in a way that incorporates all possible remedies.

Accordingly, it is suggested that the franchisor’s attorney build in core alternative remedies, with the more detailed or more specific remedies to be matters that are introduced by negotiation between the parties. In most cases it is also wise to consider including alternatives to termination. A difficult, yet avoidable scenario may arise if the franchisor serves notice of intended termination, only to have the local party call the franchisor’s bluff – particularly when it is clearly not in the franchisor’s interests to terminate the agreement.

Appendix F contains sample clauses that pertain to many of the foregoing issues.

6. Deciding to Implement Remedies

A franchisor’s view on the efforts made by the local party will determine whether the franchisor acts on the failure to achieve established targets. If such failure has resulted simply because the targets were not realistic in the first place, the first course of action should be to review the targets with the benefit of enhanced market information and agree upon a more realistic development schedule. There will also be instances where circumstances beyond the immediate control of a local party have made achievement of the development criteria impossible. The force majeure clause may cover some of these circumstances, but most will not be covered. Accordingly it will often be necessary to have a further process whereby the failure of the local party can be fairly excused.

In a recent international master franchise agreement negotiated between mature parties, and therefore reflecting a genuine and informed bargain, the following framework was established:

(i) The local party presented to the franchisor a detailed business plan following which territory development criteria were negotiated and agreed upon. The criteria were based on an agreed upon number of outlets established and operated for each year.

(ii) The local party was required at the commencement of each year to prepare a business plan outlining how it proposed to achieve or exceed the territory development criteria for that year. This plan was the subject of discussion, and ultimately became the mutually agreed plan.
(In default of agreement, the numerical criteria established in the development schedule applied).

(iii) Any overachievement in a particular year could be carried forward to subsequent years.

(iv) In the event of failure to meet the numerical criteria for any year, the local party was required to provide detailed reasons for such failure. The franchisor had the capacity to accept or reject such reasons. If rejected, the matter was then referred to expert determination, with the decision of the expert being final and binding upon the parties. If the expert determined that the reasons for underperformance were outside the reasonable control of the local party, no penalties applied. Otherwise liquidated damages and penalties applied, calculated on the estimated lost revenue to the franchisor as a result of underperformance by the local party.

(v) If underperformance was substantial and such failure was due to circumstances within the control of the local party, the franchisor was able to implement additional remedies including ultimately termination.

(vi) The territory development criteria increased each year by a percentage. However there was a formal review every 3 years where the parties had the opportunity of adjusting the territory development numbers to another mechanism. If the parties could not agree on an appropriate mechanism the matter was referred for resolution to an independent expert.

Factors such as economic conditions, exchange rate variations, weather conditions, industrial action, government legislation and a range of other factors can influence performance in a territory. The force majeure clause covers some of these matters (and it is necessary to ensure that this clause interfaces properly with the territory development criteria clause, to ensure that the force majeure clause does not frustrate the franchisor’s intentions). The relative positions of countries, their exchange rates and various other factors can impact substantially upon territory development. In more developed countries such as Canada, Australia, New Zealand and in Europe, the territory development criteria can be set with greater certainty than in developing nations where there are other complexities that need to be taken into consideration. It is critical, however, for the international franchise agreement to address non-performance in the context not only of legitimate expectations, but also with respect to waivers, force majeure provisions, and other clauses in the agreement.

G. Sub-franchising

1. Permitting Sub-franchising

Franchisors often place restrictions on the capacity of the local party to appoint sub-franchisees within the territory to ensure that the local party does not try to expand the system before it is appropriate to do so. The skills required to become a successful franchisor are different from the skills required to operate the businesses successfully, and are often under-estimated. Unless the local party is experienced in franchising, it would be wise to prohibit franchising until the franchisor considers it is appropriate.

There is often a prohibition on franchising to ensure that the local party has first learned to operate the business properly and profitably in the local market. A franchisor will sometimes require the local party to operate at least one or two outlets itself at the outset in order to acquire the necessary knowledge of the system, and to enable the franchisor to verify that the local
party will in fact be able to operate the concept effectively in the market. The franchisor will sometimes even require that the master franchisee continuously operate at least one unit in order to understand fully what is going on in the market and what the sub-franchisees are facing. Although circumstances vary, it would not be inappropriate to require the local party to operate the business for a period of at least 2 years before sub-franchising. This is the case especially when the local party has no prior experience with the system or in operating a similar business in the market.

The franchisor also needs to decide whether to permit sub-franchising at all, or whether the local party in effect has the role of an area developer. Sub-franchising creates an additional level of business ownership that can be difficult for the franchisor to control, or indeed to wind up if the local master franchisee is not successful. As mentioned at the outset, master franchise agreements can take a number of forms, such as one that requires subfranchising, permits subfranchising (with area development requirements), or other forms that are built around an area representative model. Where subfranchising is required or permitted, the franchisor will typically wish to retain the discretion to at least approve prospective subfranchisees when the local party is considered sufficiently experienced and capable to manage the activity.

The franchisor’s goals are to ensure both consistency in the operation of the underlying businesses, and the proper use of the intellectual property in the territory. As discussed earlier, the best control is for the franchisor to establish direct contractual relations with any sub-franchisees through either a direct franchise agreement or a tripartite sub-franchise agreement. However, with control comes responsibility and potential liability, in addition to potential compliance costs under a tripartite agreement. Most franchisors that permit sub-franchising choose to sacrifice some control to avoid liability. Instead they seek to retain control by the following means:

(i) Specifying the form of sub-franchise agreement to be used in the territory;

(ii) Retaining the right to approve, or at least reject, any of the local party’s proposed candidates;

(iii) Retaining the right to approve or reject the local party’s suggested locations, in the case of a premises based system;

(iv) Requiring that the local party establish formal compliance and risk management processes that the local party must satisfy as part of the franchisee recruitment and location selection process;

(v) Exercising some control over the training of sub-franchisees, including possibly insisting that training take place outside the territory in the franchisor’s home country so that the franchisees are imbued with the franchisor’s home market culture.

Sample provisions relating to subfranchising are produced in Appendix G.

2. Local Market Adaptations

The franchisor needs to find a balance between permitting the local party to make necessary local adaptations to the products, system and documentation to meet the local market requirements, and simply permitting the local party or its attorney to make changes for change’s sake. There are often advantages for the franchisor in having relative consistency on a global
basis among all documentation. Furthermore, the franchisor will normally have far greater experience in franchising than the local party.

Typically the franchisor will wish to reserve judgment on local market adaptations, and commence negotiations with a strong ‘no changes without prior approval’ stance. If pressed, the franchisor could agree to a change process that involves agreed-upon approval timeframes and guidelines. However, a discretionary power, perhaps tempered by a ‘reasonableness’ proviso, is usually reserved. It is also unusual to agree to any material variations to core intellectual property. The franchisee should be required to justify on an objective basis any change requests; intuition or personal opinion as to what the local market requires is usually insufficient justification for change.

On the other hand, some markets require not only local market adaptation but indeed translation. Unfortunately many U.S. agreements are extremely complicated. As a result, the cost of translation is increased, as is the propensity for a local party to argue that it did not understand the documentation. Furthermore, some countries require a more plain English format than is normally required in North America, or the local party may need to simplify the documentation to enable it to be better able to compete in the local market against more streamlined documentation and arrangements. Each circumstance needs to be considered on its merits and in the context of the nature, skills and experience of the respective parties and overall commercial negotiations.

The extent to which the franchisor wishes to become involved in the local market will depend upon a whole range of commercial circumstances. What is important, however, is that there is minimal duplication between the role of the local party and the role of the franchisor. Ideally the role of the franchisor should be limited to prescribing the intellectual property, systems, overall format and templates to be used, with the local party having been selected due to its capacity to add local expertise and experience to ensure that the system is successful in the new market. It is common for a franchisor to be involved in prescribing the form of the franchise documentation and to provide some initial assistance with franchising, particularly if the local party has had little previous experience in sub-franchising. However, the local party is expected usually to acquire skills in a reasonably quick timeframe, to enable it to undertake most responsibilities in the local market.

Sample provisions are produced in Appendix H.

H. Division of Responsibilities

Franchisors must be careful not to over-promise and under-deliver in the local market. Time zone differences, cultural problems and the tyranny of distance can make it extremely difficult for the franchisor to provide support to the local market. The key to drafting an international franchise agreement is to ensure that the franchisor does not over-promise in terms of services and support. It is preferable to focus on the provision of intellectual property as the core responsibility of the franchisor.

Express promises to provide any additional services and support need to be carefully considered. This is particularly relevant given that any dispute between the franchisor and the local party may well be considered in a court in the local market. In some countries the local party has a fair home field advantage. If the international franchise agreement is seen to be essentially an intellectual property license, it is more likely to be upheld than if it also contains a range of services and support that have arguably not been provided.
In a transaction between an informed franchisor and a master franchisee, the core services that
a local party might reasonably expect would be as follows:

(i) Guaranteed provision to the local party and any sub-franchisees of the core intellectual
property, including trademarks, copyright material, product names and manuals.

(ii) Protection of the intellectual property. This would include registration of trademarks,
brand names and domain names in the local market, and support of the local parties in any
infringement action.

Intellectual property protection may take two forms. The first may be the protection by
registration of the core intellectual property, and the protection of the local party against any
claims by third parties claiming ownership of the intellectual property or purporting to restrict the
capacity of the local party to use it in the territory. This ought to be the franchisor's
responsibility. On the other hand, maintaining the intellectual property in the territory at a more
micro level ought to be the responsibility of the local party. For example, if a competitor seeks
to use some of the intellectual property in its business, it would be reasonable to expect the
local party to take action to protect the intellectual property in the market.

At the same time, the franchisor may wish to reserve an overriding ability to compel the local
party to notify it of any local market infringement and to take enforcement action as required.
The structure of the intellectual property licensing would to some extent determine the capacity
of a party to take action in the local market. For example, if the infringement is a trademark
infringement, only the registered proprietor will have the capacity to take enforcement action
unless local trademark laws or the international master franchise agreement specifically
empowers the local party with the rights to take action.

(iii) Access to new developments in the system, new products, customer data,
benchmarking, information and other material in the possession of the franchisor that could be
useful for the master franchisee in the local market.

(iv) Access to general support and advice concerning systems issues, training and other
matters on an ad hoc basis, perhaps supplemented by occasional international meetings or
conferences where ideas are exchanged. In terms of training and ongoing support, it would be
legitimate for the local party to expect comprehensive training from the foreign franchisor in
relation to the operation of the business, the expansion and development of the business in the
territory, and instruction on how to train its own employees and subfranchisees (sometimes
called “train the trainer” training). At the same time, it is reasonable for the franchisor to expect
that the local party will quickly acquire these necessary skills to train and support additional
employees and subfranchisees in the territory.

A certain amount of initial training is included normally as one of the services provided in
exchange for payment of the initial fee to the franchisor. Ongoing training and support to other
members of the local party’s staff and to sub-franchisees would normally only be provided at the
cost of the local party. Wherever possible, it would be prudent to limit the franchisor's
responsibilities to providing the operations manuals and any adaptations (with the local party to
bear the cost of local customization or translation) and providing web or email based support.
The difficulties posed by international time zones make it difficult for a franchisor to deliver on
service and support promises during the regular business hours of the local party where that
local party is located outside North America.
(v) General assistance with advertising and marketing. Quite often the local party is responsible for advertising, marketing and promotion in the local market. The franchisor will be expected to provide ideas, materials and templates for local adaptation, but the franchisee’s involvement is usually relatively minimal, and limited to occasional input and overseeing any significant advertising for brand compliance. If the foreign franchisor wishes to obtain a contribution from the local market to a global advertising or promotional fund, this needs to be included in the contract. Normally, however, a foreign franchisor will be sufficiently satisfied if the local party commits to a certain level of advertising, marketing and promotional expenditure in the local market.

The nature of the necessary marketing expenditure may vary from market to market. It will be necessary for the local party to promote the business and the goods and services in the local market. If there are any sub-franchisees it would be customary for a certain percentage of sales to be set aside for local marketing and promotions. However, in addition the foreign franchisor will wish to see the local party spend reasonable resources on brand building. The responsibilities of the local party under the international master franchise agreement therefore may be twofold: first, to manage the local advertising marketing and promotions fund; and second, to spend a specific amount of money on actual brand building initiatives in the territory.

The franchisor may also wish to vet all advertisements and marketing and promotional initiatives to ensure that the brand is accurately represented and adequately promoted. The extent to which the franchisor wishes to be involved in this area will depend largely upon the skill and experience of the local party and the projections for network development. In the early stages of development, there may simply be insufficient funds to devote to brand-building, as all dollars will be required for promoting the goods and services of the business to customers.

Sample provisions pertaining to the foregoing issues are produced in Appendix I.

I. Default and Consequences of Default

Great care should be taken when drafting the default and termination provisions of an international franchise agreement. The grounds for default will in many ways be similar to those in a domestic context, such as fraud, insolvency, abandonment, and material breaches. However, the consequences of breach should be thoroughly considered before they are included in the agreement. In many cases, termination will not be consistent with the best interests of the franchisor, since the franchisor may face post-termination responsibilities such as the legal and/or practical obligation to support and manage the sub-franchisees located in the territory. Alternatively, termination may be just what the local master franchisee wants, and may simply create a competitor in the local market. This is of course particularly relevant if post-term restraints are not enforceable.

Where the franchisor franchises directly to the unit franchisees in the territory, with the local party forming more of an area representative role and not in direct contractual relations with the local franchisees, the consequences of termination are relatively straight-forward and the foreign franchisor can draft the agreement without needing to be particularly inventive as to default arrangements. However, where it is a structure built around subfranchising, a franchisor needs to consider what it intends to do should circumstances arise where the master franchise agreement for the relevant territory needs to be terminated. The franchisor also needs to consider its legal position vis-à-vis the local unit franchisees.
Some franchisors are prepared to commit to a specific course of action on termination of the local master franchise agreement. In this scenario, the agreement - including sub-franchise agreement - can be quite prescriptive. In most instances, however, the franchisor will prefer to adapt a wait-and-see approach, rather than committing to enter the territory to support the local franchisees. This is the case particularly during the early stages of the network’s development. As the size and value of the network grows, however, it may become more important for the foreign franchisor to be able to intervene to protect its income stream.

There are means by which a franchisor can achieve both objectives. The franchisor could refrain from having any direct contractual relationship with the sub-franchisees located in the territory, yet include in the agreement an option to take on the responsibilities of the local party in the territory and thereby assume all rights, entitlements and obligations in the territory, or to confer third party beneficiary status on the franchisor where permitted by law. To achieve this result, it would be necessary to ensure that the assignment provisions under the unit franchise agreement were adequate to permit assignment between the master franchisee and the franchisor if necessary. It may also be necessary to have a power of attorney clause to enable the franchisor to effect the assignment of the subfranchise agreements on termination of the agreement if the local party is unwilling to comply with an obligation to do so.

To some extent, the remedies that the franchisor requires may depend upon the nature of the local party’s default. The viability of the business in the local market may also be relevant, in that a franchisor will be much more inclined to take over the maintenance, support and development of a viable and profitable network than one that is struggling at unit franchise level.

For those franchisors seeking additional or alternative remedies to termination, the suggestions outlined in Section IV.F.5 above merit consideration.

A local party will often be restrained from engaging in competitive activities during the term of the agreement, and for a minimum period after termination. However, enforceability could very well be determined by local law, and post-termination covenants must often meet the local law’s standard of reasonableness to be enforceable. For instance, it could be difficult to justify a restraint larger than the defined territory, and restraints for periods longer than a reasonably short fixed period of time (i.e., 1-2 years) may be problematic. Indeed, in some jurisdictions post-termination restraints are entirely illegal. Yet certain circumstances justify wider and longer restrictions -- such as a local master franchisee that is a global corporation, or has the capacity to use the franchisor’s intellectual property in areas outside the local market. Whatever the case, is it is critical that the restrictions apply not just to the corporate entity but also to any key individuals, otherwise the benefits of the restraints can be illusory or easily circumvented.4

J. Dispute Resolution

In any international agreement, it is critical to specify with care the mechanisms for resolving disputes. It is even necessary to consider, and sometimes differentiate between, the likely types of disputes and how they are best resolved. Failing to do so can prejudice enforcement, lead to unintended commercial outcomes, and add to costs.

In most situations, there are advantages to being on home ground as opposed to foreign territory. There is a reason that sports teams win more often at home than on the road:

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4 For sample default provisions, refer to Appendix F.
familiarity with one’s surroundings improves confidence and performance. Similarly, as lawyers, our preference is to choose concepts that are the most familiar to us. When drafting international franchise agreements, it is therefore logical for counsel to prefer home soil when considering dispute resolution mechanisms, and the variables that are relevant to dispute between parties located in different countries. To complete a complex international franchise agreement, it is necessary to choose the applicable language, law, dispute resolution format and venue for disputes. A lawyer’s intuitive preference for home jurisdiction decision may in many cases be the correct choice. However, there are a number of circumstances when selecting of the home ground option may in fact prejudice the enforcement of the agreement, or add avoidable costs to the management of the relationship and the dispute resolution process. Alternatively, the parties may add complexity, uncertainty or cost by failing to properly integrate the language, law and dispute resolution clauses so that they are consistent and efficient.

This section addresses some of the leading issues to be considered in these areas when drafting and negotiating international master franchise agreements.

1. Choosing the Method

It is generally wise for a franchisor to develop a template dispute resolution framework that can be adapted from country to country with input from local counsel. Typically, the format will have an escalation process beginning with a mandatory meeting between senior management or company presidents and ending with either arbitration or court action in a specified location. In between can be various other mechanisms including expert determination, mediation or conciliation. Expert determination can be useful for technical or financial issues, or matters not covered by the relationship where a quick cost-effective independent decision is as important as the decision itself. Mediation is being used in franchising in an increasingly successful manner, although in an international context the lack of an assured result can mean parties are less willing to incur travel and other costs to attend. It is a country by country decision influenced by local and international factors. In some countries there are no experienced mediators or arbitrators, or these methods are detriments to finding a resolution, so the court system may be the only option. In other countries, the courts may be problematic due to lack of judicial experience or independence, political prejudice or even corruption.

Appendix J contains arbitration and mediation provisions that illustrate how such clauses may be drafted.

2. Choice of Language

The choice of language clause determines the language that governs the contract. Where contracts are in more than one language, this clause will determine the language that represents the official version of the agreement.

At first glance this type of clause may not be considered to be particularly important. The negotiating parties may understand the commercial terms, or may even be fluent in both languages directly or as a result of the use of interpreters. However, in the event of a dispute in a location where the chosen language is not the language of the country where the dispute is to be decided, there may be significant additional costs in interpreting the contract for the court.

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5 In Australia, for example, over 70% of franchising disputes are now successfully resolved via mediation.
On one view, the chosen language should be the language of the original draft rather than the translation, as errors in the translation of legal documents are common. This might be important where documents are highly technical, or where the agreement contains terminology that is not easily translated (such as industry jargon). At the same time, it is critical to ensure that a true meeting of the minds occurs, and that both versions say the same thing. Accordingly, there is some justification for having either language the official language, and for both parties to engage a translator to ensure that in fact the documents say exactly the same thing in both languages.

In negotiating the choice of language clause, the parties must address various issues in addition to the legal concerns mentioned above. There can be issues of translation costs, national pride, “face” or even legislation to consider. This is particularly an issue in some Asian countries. In Indonesia, for instance, a franchise agreement must be drafted in the local language. In China, where dealings often involve government officials, there may be pressure to include a clause that gives Chinese law at least equal recognition within the franchise agreement.

Sometimes rather pragmatic compromise solutions are sought. However, choice of a neutral language is not recommended unless that language is also the law of the contract and the country in which disputes are resolved.

3. Choice of Law

The choice of law clause establishes the governing law of the contract, and determines how the contract will be interpreted. Typically the choice of law clause will be linked to the chosen venue for dispute resolution. However, the choice of law and choice of venue clauses do not cover all conduct by the parties.

Local laws still apply in relation to conduct within a country, and will in most cases override the choice of law clause. For example, local franchise laws (including those in Australia and Canada) will still apply, in whole or in part, to conduct in an international master franchise agreement (and ancillary documents), notwithstanding that the law of another country may be the applicable law specified in the agreement.

The best such a clause achieves on its own is to give the party in that location the opportunity to initiate proceedings in the location. However, if the other party has no assets in that jurisdiction, or the judgment is unlikely to be enforced in the master franchisee’s jurisdiction, choosing the franchisor’s own jurisdiction will provide no advantage to the franchisor.

The main justifications for choosing a particular law for interpretation of the contract are in fact legal certainty and consistency. In an international context, some countries do not have a strong body of case law to establish legal principles. For instance, the business of franchising is relatively new to many Asian countries, so the existing law in that area is at an early stage of development. It is therefore important that an international franchisor can be fairly certain that a remedy will be possible.

Some have suggested that an advantage of the choice of law clause for franchisors is that they do not need to obtain separate advice as to the enforceability of the provisions of the master franchise agreement and ancillary documents from local counsel. However, this is only partially correct. Franchisors need to understand what local conduct laws might apply to the franchise relationship. Regardless of the choice of law, franchisors should also consider the types of remedies they are likely to require if a local party does not comply with the agreement. If the
4. Choice of Location for Dispute Resolution

The courts are often loath to override the mechanisms that the parties have chosen to resolve disputes. Accordingly, the parties to the franchise agreement have an opportunity to define the dispute resolution process. Of course this will not prevent a court from intervening if a dispute is conduct-based rather than contractual.

The location chosen for dispute resolution will often be the same as choice of legal jurisdiction. The franchisor needs to understand from its domestic and local counsel the extent to which such a designation will be enforced, and also whether there are any advantages to the franchisor. Similarly, local laws may render the contractual provisions unenforceable, such as those franchise laws that limit a contract’s ability to restrict access to local courts.

With respect to Australia, for instance, choosing a governing law and venue that is not Australian can be problematic. Due to legislation such as the Trade Practices Act, it is highly likely that disputes will be based on allegations of breach of statute rather than breach of contract. Accordingly, the parties should address the likely areas of dispute and identify the desired remedies. For U.S. franchisors, it may not necessarily make sense to have U.S. law applying to the contract. For example, it would make no sense to apply U.S. law if disputes were to be resolved in a foreign country which had local conduct laws that are relevant to the dispute and no familiarity with U.S. laws. In such a scenario it would be necessary to have American legal experts flown to Australia to assist in resolving disputes.

On the other hand, retaining home field advantage can have tactical advantages in some cases. Dispute resolution clauses can sometimes be used by franchisors to discourage disputes. For example, several U.S. systems that franchise directly into Australia have dispute resolution clauses that provide for arbitration in the United States if unsuccessful preliminary steps such as mediation have been followed. There is a significant incentive for a unit franchisee to settle during the early phases, rather than fight a battle in the U.S., irrespective of the merits of the case.

K. Transfers

The typical franchisor will wish to be as free as possible to determine the future direction of its business. In particular, the franchisor will want to retain the ability to merge with or acquire other businesses, establish new distributions, raise capital, or even sell the business itself. As a consequence, an effective franchise agreement will establish clearly the rights of the franchisor in all such areas. It is very rare for the franchisor to fetter in any way its ability to transfer to any person and in any manner it thinks fit.

A master franchisee will also enter the relationship with an exit strategy in mind. A core motivation for acquiring the master franchise will be to build a capital asset that can be sold for a substantial price at some future point. As a general rule, a franchisor will not be totally averse to the master franchisee transferring its business. However, the franchisor will wish to ensure it has strong controls over the terms and conditions under which and to whom the master franchisee may transfer its business. A franchisor needs to know with whom it is in business and to whom it has entrusted its trademarks and business system.
Transfer provisions highlight the natural tension that arises between the spirited entrepreneur that is likely to want to start, operate, and sell a business to the highest bidder, and the franchisor who sees the master franchisee as a smaller part of a global network and wishes to ensure that any transferee is an experienced business person who will faithfully follow its standards, rules and regulations. Faithfully following standards, rules and regulations and having an independent spirit are not always compatible traits.

A sophisticated local party will know to pay attention to these issues. Sometimes, however, a less sophisticated party may overlook completely these provisions and it will be the job of the lawyer to point out their importance and help focus on the requirements and determine whether they are acceptable.

Some franchisors are highly prescriptive. Franchisors of this type will likely prohibit any transfers to a competitor, require extensive approval conditions, and insist that the transferee devote its full attention to the business.

In recent times, some franchisors have begun to acknowledge that it may be acceptable if a master franchisee runs another business, even as a master, so long as there is no direct competition with the franchisor. By virtue of this pre-existing business activity, the master franchisee likely will have further experience that can be beneficial to the franchisor.

With respect to transfers, the master franchisee may view the business as its own. From this approach, the sale or transfer of the business may seem intuitively to be well within the rights of the master franchisee. While most master franchisees are well-versed on the terms of the operations manual, the transfer provisions of the master franchise agreement are often unknown or poorly understood. In contrast, the only sin more heinous to the franchisor than failing to pay royalties or abusing the trademarks is transferring the franchise without consent. The franchisor has a vested interest in the background, identity and experience of the master franchisee for purposes of ensuring that the business runs at the optimum level throughout the term of the agreement, to maintain the revenue stream, protect the confidentiality of the system and know-how, and the integrity of the licensed marks. Even more important is keeping all of these items out of the hands of direct competitors or less qualified operators. The franchisor does not want to find itself, through the actions of one of its franchisees, in business with someone that would never have been selected in the first place.

Although they are conceptually similar to the transfer clause in a unit franchise agreement, the pre-conditions to approval are usually more extensive. The requirement of prior written consent is followed less often by the phrase, “which consent will not be unreasonably withheld”. Rather, the agreement is more likely to reserve to the franchisor an ability to withhold consent in many circumstances or even in its absolute discretion.

A transfer clause in the franchise context usually encompasses the master franchisee’s voluntary, involuntary, conditional, direct or indirect assignments, sales, gifts or other transfers or those of any of its owners of any interest in or grant of any security interest in the master franchise agreement, the franchise, the assets of the franchise business, the master franchisee or any entity directly or indirectly controlling master franchisee. An assignment, sale or other transfer would include:

(i) the transfer of ownership of shares or a partnership interest;
(ii) merger, spin off, split off, or consolidation or issuance of additional securities representing an ownership Interest;

(iii) any sale of voting shares of master franchisee or any security convertible to voting shares of master franchisee or any agreement granting the right to exercise or control the exercise of the voting rights of any holder of an ownership Interest;

(iv) transfer in a divorce, insolvency, corporate, partnership or other dissolution proceeding or, in the event of the death of master franchisee or an owner of master franchisee, by will, declaration of or transfer in trust, or under the laws of intestate succession or otherwise by operation of law;

(v) transfer upon the permanent disability of master franchisee or an owner;

(vi) the transfer of any or all of the assets of master franchisee (except for the sale of inventory in the ordinary course of business); and

(vii) the transfer of any interest, right or obligation of the master franchise agreement.

It may be that the discussion regarding the importance of this provision to the parties does not occur at the outset because the occasion of a transfer does not arise until later in the life of the relationship. This is unfortunate indeed. Both parties need to be educated as to the needs of the other, and this provision thoroughly vetted by each prior to entering into the relationship. The franchisor’s standard conditions for approval of a transfer generally follow a fairly universally accepted list of requirements. A typical transfer provision with alternate provisions (including provisions negotiated to take into account a publicly listed master franchisee’s concerns) is produced in Appendix K.

The franchisor is not usually insensitive to the realities of the business world. In recognition of corporate governance, internal franchise business structure issues, the need to raise capital, death, disability and the like, franchisors treat certain types of transfers somewhat differently and often specifically deal with them in the master franchise agreement. Franchisors will require notification in all instances and often require an amendment to the master franchise agreement or execution of relevant documents. However, these types of transfers generally meet with less strenuous scrutiny, and often a waiver of any applicable transfer fee. Compliance with the terms of the master franchise agreement, however, will always be a threshold requirement for any transfer.

Transfers that the master franchisee completes without the consent of the franchisor constitute serious breaches of the agreement that can result in, among other things, immediate termination and retention by the transferor and its principals of full liability. The evaluation of a potential transferee and the consent of the franchisor to a transfer serve several purposes. For example, and aside from the obvious need for the franchisor to assess the potential transferee’s ability, the franchisor should evaluate the proposed arrangements to decide if it wishes to exercise any right of first refusal that it may have reserved to itself in the agreement. In addition, the franchisor should also make sure that the financial terms will not burden the transferee with excessive debt.

It is also in the interest of the franchisor to make sure that the transferor does not sell for a grossly inflated amount that bears no relation to fair market value, as that leaves a new master franchisee doomed to failure. A franchisor will generally bargain for a continuous revenue
stream and choose a master franchisee based with that in mind. To be left, after a transfer, with less than that is not acceptable from a contractual perspective. It is quite common to ensure that the master franchisee remains liable after the transfer in order to ensure the continued success of the business. This type of arrangement also hedges the risk to the franchisor and keeps the exiting master franchisee honest and interested in the success of the transferee.

Prior to consenting to a transfer, a franchisor often has a right of first refusal to acquire any interest sought to be transferred. The franchisor will retain this right in order provide the flexibility to, among other things, reacquire the territory in the event of changes in its business strategy. Retaining this right will also enable the franchisor to find out earlier about any proposed sale, and will assist with obtaining financial information about the business it may not possess. Moreover, it may even provide the franchisor the opportunity to influence the price.

This type of provision, which is sometimes drafted as a first and last right of refusal to give the franchisor greater control, will often be met with resistance from the master franchisee. Even the existence of such a clause often discourages potential sales of the master franchisee’s interest, and imposes the necessity of conditions and warranties that might not otherwise be part of a third party’s offer.

L. Compliance with U.S. Laws of Extraterritorial Jurisdiction

In the United States, certain laws extend to the extraterritorial activities of American citizens. A well-known example is the Foreign Corrupt Practices Act, which contains various anti-bribery provisions that apply to American citizens and their interaction with foreign officials. The events of September 11, 2001 also led to new legislation that imposes various knowledge requirements on U.S.-based franchisors. In particular, franchisors face an affirmative obligation to actively investigate the parties they intend to contract with, along with their prior activities. The impact of these laws needs to be considered in the context of proposed transferees, and most transfer clauses so provide.

Since federal law requires that franchisors comply with this legislation, a master franchisee’s objections to the inclusion of such provisions in the franchise agreement cannot be permitted to change the contract. Local embassies and the U.S. Department of Commerce can be of assistance in obtaining this information for a franchisor. These requirements will apply at the outset, and in respect of candidates to a transfer. As a result, franchise agreements may now be required to contain certain representations and warranties specifically related to these types of activities. Examples of such clauses are contained in Appendix L.

M. Waivers

Most U.S.-based franchisors develop master franchise agreements that contain expansive waiver provisions, such as the waiver of: jury trials, consequential damages, punitive damages, exemplary damages, special damages, deceptive trade practices laws, and initiating or becoming involved in a class action lawsuit. This may, in part, arise as a result of the litigious nature of the business environment that prevails in the United States. Just as likely, however, is

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6 The Patriot Act introduced various legislative requirements aimed at eliminating money laundering among terrorist organizations and other targeted organizations. These laws increased the penalties against such activities, and imposed affirmative obligations upon businesses to inquire into the activities of their business partners. These requirements include checking the Office of Foreign Assets Control’s list of Specially Designated Nationals and Blocked Persons. These lists can be found on the OFCA’s website.
that it reflects good business judgment on the part of the franchisor making efforts to avoid putting itself in the hands of a jury that may not understand the intricacies of a franchise relationship. In the U.S., such provisions are usual and customary in most contracts. Internationally, however, they can be viewed as overly broad, overreaching and sometimes offensive. However they are perceived, they are certainly not widely accepted outside the United States. Of all these waivers, the only one with mutual benefit among them is the waiver of consequential damages.

In the U.S., the “waiver of jury trial” has received significant scrutiny. From the master franchisee’s perspective, a waiver of jury trial is, in some countries, the waiver of a constitutionally protected right. In some jurisdictions such a waiver may be unenforceable as a matter of public policy. In some countries civil jury trials may already be unusual or non-existent, and so the waiver is not necessary.

Like the above, a waiver of punitive damage awards appears in many contracts due to the US litigation experience. Like the waiver of a jury trial, however, such a provision may not be effective in the local market.

In the end result, local counsel should be consulted on the necessity and effectiveness of all such waivers. Otherwise the U.S. franchisor should not count on their enforceability in the context of an international agreement. Examples of some typical waiver provisions are contained in Appendix M.

N. Rights of First Refusal for New Territories

Many prospective franchisees wish to consolidate their control over a region by having the right to expand to a geographically larger territory or an additional territory. Although requests for rights of first refusal are commonplace, they are fraught with uncertainty and are sometimes impractical and difficult to administer. Rights of first refusal give the master franchisee an opportunity to lock up territory without absolutely committing to its development.

Sometimes franchisors see the granting of extra rights as an easy concession to make, particularly if they have no present intention to expand into that territory. Invariably, such concessions come home to haunt the franchisor, particularly if the concessions are made at the last minute and are not broadly communicated. Even tying the extra territory to the performance clause can be problematic in circumstances where, for instance, an offer for the extra territory is received very early in the relationship before the master franchisee can be said to have succeeded or failed to perform.

In some instances, the franchisor will require additional consideration for this right at the outset. This may, among other things, defray costs, compensate for the deferral of a corporate opportunity, or compensate franchisor for the added complication of having to comply with this time consuming and potentially deal chilling precondition to any third party transaction.

If the master franchisee turns out to be a great operator, the franchisor would generally welcome the development of additional territories by an experienced franchisee. The benefits in this situation are mutual. On the one hand, the master franchisee will be able to take advantage of economies of scale, favorable logistics, shared management, and size. On the other hand, the franchisor, without the need for additional training, would secure a new source of revenue and the benefit of a seasoned master franchisee who knows the system and how to run the business. This is likely to improve the possibilities of success in the new region.
If the master franchisee has had only limited success in its first outing, the franchisor will be less inclined to honor the right of first refusal but, being contractually bound, will have little choice in the matter. In this instance, an approach by a third party may be an exercise in frustration for the franchisor. The franchisor may find itself, depending on the terms of the right of refusal, negotiating with someone that appears to be far superior to the existing master franchisee with the right of first refusal. To honor the right of first refusal, the franchisor would be obliged after reaching preliminary agreement, to hold the potential developer off while the opportunity is offered to the holder of the right of first refusal. The time delay related to the right of first refusal process itself could result in the loss of the third party transaction. Third parties who are aware of the existence of the right of first refusal are often loath to spend time and money negotiating a transaction that might be impossible to conclude.

Where the potential developer is the franchisor, the existing holder of the right of first refusal will want more than the franchisor’s word that it intends to develop a new territory. Holders of rights of first refusal do not want to be prodded into development before they are ready. To keep the franchisor honest, the holder of the right of first refusal may want something tangible such as a business plan or other evidence of the franchisor’s intent.

Developing a new territory can be a major distraction from the master franchisee’s existing business. This type of endeavor tends to divert attention and drain resources – both financial and human. If territorial expansion is initiated prematurely, the existing business may either suffer or, worse yet, be lost all together at the expense of the new development. To forgo the opportunity, however, is to possibly loosen its hold in the region and allow a competitor – albeit a friendly one – to move into the area.

Appendix N contains examples of rights of first refusal and rights of first consultation.

V. CONCLUSION

The legal and commercial issues addressed in this paper highlight only some of the potential concerns that may arise in the context of an international franchise expansion. Indeed, individual business needs and objectives vary to such an extent that generalizations and authoritative positions are unlikely to be helpful. However, our combined experience as franchise lawyers has enabled us to produce the foregoing collection of tips and advice concerning the most common issues that must, at some point or another, be confronted by franchisors seeking to expand internationally.

One firm position that can be drawn from our analysis is that these issues should be addressed at the earliest possible opportunity in order to increase the likelihood of a successful negotiation process. By engaging knowledgeable domestic and foreign legal counsel at the outset of the expansion effort, franchisors will receive the specific advice needed to develop a proactive strategy that minimizes financial risks and increases the chances of a successful long-term business venture.
APPENDIX A

GRANTING AND RESERVING FRANCHISE RIGHTS

EXAMPLE 1:

Section 3.2 Master Franchise - The License

A. We hereby award you a license for the Territory only to:
   i. establish and operate a Master Franchise Business in accordance with this Agreement, the System, Marks, Manuals and other written instructions from us;
   ii. enter into one or more a Unit Franchises for a Master-Affiliated Units;
   iii. enter into Unit Franchise Agreements as a subfranchisor in compliance with this Agreement; and
   iv. enter into Software Licence Agreements and Intranet User Agreements (each of which is a schedule to the Unit Franchise Agreement) as a sublicensor in compliance with this Agreement.

B. The license granted to you by Section 2.2A shall be exercised only under and subject to all terms and conditions of this Agreement. You have no rights in the System or any of the Marks except as specifically granted herein. You may only award Unit Franchises to be operated within the Territory.

Section 3.3 Scope Of License

A. Subject to our reserved rights and the other provisions of this Agreement, we will not enter into a Master Franchise Agreement or Unit Franchise Agreement for the award of a Master Franchise or a Unit Franchise or own or operate a Franchised Unit ourselves, inside the Territory during the currency of this Agreement. Your rights in the Territory are exactly (and only) as expressly set forth in this Agreement. This Master Franchise Agreement does not grant you any rights with respect to any other business, product or service, in which we or any Franchisor-Related Persons/Entity may be involved, now or in the future.

B. We and Franchisor-Related Persons/Entities reserve all rights not expressly granted to you hereunder, including among them the rights to:
   i. hold or operate ourselves, or authorize others to hold or operate:
      a. any kind of business in the Territory (except for a Master Franchise Business or a Franchised Unit) and selling to Customers located anywhere, subject to Section 3.3D; or
      b. any kind of business outside of the Territory, whether or not using the Marks and System, including without limitation, a Master Franchise Business or a Franchised Unit, and selling to Customers located anywhere;
   ii. develop or become associated with other businesses or concepts, and award master/unit franchises or operate units/channels of distribution owned by us or any

7 These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
Affiliate of ours under such other concepts for locations anywhere and selling to Customers located anywhere; and

iii. acquire, be acquired by, merge with, affiliate with or engage in any transaction with, any other business (whether competitive or not), which has units located anywhere and sell to Customers located anywhere. Such transactions are expressly permitted under this Agreement, and you agree to participate at your expense in any brand or system conversion resulting therefrom, as instructed by us.

C. Subject to Section 3.3D, we may choose, in our Business Judgment, to offer/provide products or services of any type, whether or not using the Marks, System or any other Intellectual Property, through the Internet, World Wide Web, mail order or other venues (no matter where the Customer or the relocation site is located). Your use, if any, of the Internet, the World Wide Web, or other electronic media for marketing and distributing Unit Franchises, goods or services (or both) must comply with any standards or procedures that we establish from time to time in our Business Judgment. You agree not to market or sell through such venue(s) without our written permission. We also may establish standards and procedures regarding Special Accounts for you to follow, and you agree to comply with any such standards and procedures.

D. Before operating or authorizing a third party to operate any kind of business in the Territory, and before offering or authorizing a third party to offer any new product or service in the Territory during the currency of this agreement (other than as part of the System), we will offer you the opportunity to operate such business and sell such products and services on our terms. If you do not accept our offer in writing within 14 days from the date you receive notice of it, we may operate such business and sell such products and services (or authorize a third party to do so) on substantially the same terms, without further notice to you.

E. You understand that nothing in this Agreement prevents us or another Master Franchisee, Unit Franchisee, Master-Affiliated Unit, or any other person from originating moves within the Territory or from moving Customers located outside the Territory to relocation sites within the Territory. Our current policy is to allow you and your Unit Franchisees to accept requests from prospects and/or orders from any Customer located anywhere and to sell to Customers located anywhere, but not to allow Unit Franchisees to conduct direct marketing outside of their respective Marketing Areas. We may change this policy from time to time in our Business Judgment. You agree to comply with all policy changes.

EXAMPLE 2: Reservation Of Rights

1.04. Developer shall have no right under this Agreement to license others to use the Proprietary Marks or the Business System.

1.05. Except as described in Section 1.02 herein, Franchisor and its affiliates have the right to operate and grant as many other franchises for the operation of ____________________ restaurants anywhere in the world. Notwithstanding the territorial rights granted pursuant to Section 1.02, Franchisor reserves, and Franchisee agrees that Franchisor and its affiliates shall have, the right to:

A. establish and operate, and to license others to establish and operate, ____________________ restaurants anywhere outside of the Territory; and in the Territory at United States military bases or other non-U.S. military facilities, which are
now, or may at any time hereafter, be located within the Territory; in the Territory at: shopping malls, hospitals, schools, universities, colleges, mass transportation vehicles, including, without limitation, airplanes, trains, buses, and ferries and ships, travel facilities, including, without limitation, airports, train stations, bus terminals, highway travel plazas, and port facilities; sports facilities and entertainment facilities, and related events, including, without limitation, stadia, arenas, amphitheatres, theme parks, amusement parks, zoos, concert venues, and drive-ins and theatres, governmental cooperatives, institutional facilities and government facilities, including, without limitation, those related to education, health care, the military, and any facility owned by, operated by, or under contract with any government agency, regardless of whether or not any of the foregoing are in close proximity to a Franchised Unit;

B. operate, or grant to others one or more franchises to operate restaurants or other food outlets using different principal trade names or trademarks, anywhere in the world, regardless of whether or not any of the foregoing are in close proximity to a Franchised Unit; and

C. distribute, offer, or grant to others the franchise or right to distribute or offer, the same or similar products and/or services as those offered by ____________________ restaurants, regardless of whether they are using the same Proprietary Marks, of a temporary or permanent nature, anywhere in the world, by means of alternate channels of distribution such as without limitation, by or through; (i) mail order, television, vending machines, electronic media (i.e. internet) or catalogue sales; (ii) through catering, catering trucks, carts, and/or home delivery services; or (iii) supermarkets, grocery, retail or similar stores, or as a concession, kiosk, department or as part of or in combination with any such supermarket, grocery, retail or similar establishments, regardless of whether or not any of the foregoing are in close proximity to a Franchised Unit.
APPENDIX B

FEE STRUCTURE

Section 4.1 Initial Master Franchise Fee And Unit Fees

A. In consideration for the execution of this Agreement, Master Franchisee will pay Franchisor a total initial fee for the Master Franchise of US$225,000 (the “Initial Fee”). You will pay us the Initial Fee (in total, US$225,000) on or before the Effective Date by wire transfer in the equivalent amount of Canadian Dollars (C$) calculated at the date of payment by reference to the U.S.-Canada currency exchange rate of the Bank of Canada prevailing at the payment date. The Initial Fee is due and payable and is fully earned by us on the Effective Date, and thereafter are entirely non-refundable under any circumstances, regardless of when, why or how this Agreement may later be terminated.

B. Within 20 days after the earliest of the date when:
   
   i. you execute any Unit Franchise Agreement and receive payment of the Unit Fees payable thereunder;
   ii. Franchised Unit opens for business (including a Master-Affiliated Unit), or
   iii. any Franchised Unit is required to open for business under or otherwise,

you will pay us an amount equal to 20% of our then current Unit Fee. However, you are not required to pay any amount on account of a Unit Fee for the first Master-Affiliated Unit opened by your Affiliate.

Section 4.2 Royalties

For each Unit (including Master-Affiliated Units), you will pay us within 20 days after the end of each month (or other payment period as designated in writing by us) 1.5% of such Unit’s Gross Revenues for the immediately preceding month (or other payment period as designated in writing by us).

We may, but are not obligated to, authorize you to sell certain Products and Services to Units for the Units’ resale to consumers or for other purposes approved by us. The two of us mutually agree that Unit revenues earned or received in connection with such sales (by all Unit Franchises, including Master-Affiliated Units) shall be included in Gross Revenues for Royalty calculation purposes. You agree that any such Products and Services shall be distributed and sold exclusively to and through Franchised Units.

Section 4.3 Advertising Fees

No amount will be due from you in connection with Advertising Fees received by you from Unit Franchisees exclusively for the National Advertising Fund provided they are spent as approved by us in advance, in writing (and otherwise in compliance with this Agreement).

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8 These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
Section 4.4 Full Amounts Owed

You are free to decide upon the financial terms of any Unit Franchise Agreement, except that we may specify maximum amounts for Royalties, fees, Products and Services and other products or services from time to time embodied in the System. In any event, you agree to pay us a minimum of US $2,000.00, with respect to any assignment or renewal of a Unit Franchise. All amounts due us under this Agreement or any other agreement will be paid by you as provided in section * hereof and will be paid when due and in full, whether or not you have collected such amounts or decide to finance, defer or waive payment of any portion of the amounts due you from your Unit Franchisees, including any Master-Affiliated Units or Affiliates. All amounts paid to us are entirely non-refundable unless we in our sole discretion expressly agree otherwise in writing.

EXAMPLE 2: Area Development Fee Structure

5.1 Initial Fees

In consideration of the Area Developer receiving the rights specified herein, the Area Developer shall pay to * an initial, non-recurring, non-refundable initial fee in the amount of Three Hundred and Thirty Two Thousand Five Hundred Dollars ($332,500.00), plus applicable taxes. The initial fee shall be deemed to be fully earned by * upon the execution of this agreement, and the Area Developer shall not be entitled to a refund of any part thereof, regardless of the date of expiration or termination of this agreement. The initial fee shall be payable in full upon the execution of this agreement.

Provided further that for the Franchises that the Area Developer is obligated to develop, open and operate in accordance with the development schedule set out in Schedule “B” (Performance Criteria), the initial franchise fee shall be reduced from $35,000 to $17,500. Any Franchises developed in addition to those required by the development schedule set out in Schedule “B” (Performance Criteria) shall require payment of the full $35,000 initial franchise fee.
APPENDIX C

TAXES AND DUTIES, CURRENCY, WITHHOLDING\(^9\)

A. Withholding Taxes with a Gross Up

If any Tax (other than income tax) is imposed on Franchisor by reason of its performing its obligations under this Agreement, Franchisee shall:

(a) notify Franchisor of any such requirement or any change in any such requirement as soon as Franchisee becomes aware of it;

(b) pay any Tax before the date on which penalties attach thereto; such payment is to be made if the liability to pay is imposed on Franchisee for its own account, or if that liability is imposed on Franchisor, on behalf of and in the name of Franchisor;

(c) increase the Taxable Payment to the extent necessary to ensure that, after the deduction, withholding or payment, Franchisor receives on the due date a net sum equal to what it would have received if no such deduction, withholding or payment was required or made; (emphasis added) and

(d) within 30 days after the earlier of (i) the date of the Taxable Payment; or (ii) the due date for payment of any Tax which it is required to pay as a result of the Taxable Payment, deliver to Franchisor evidence satisfactory to Franchisor of such deduction or withholding and of the remittance thereof to the relevant taxing or other authority.

B. Withholding Taxes – No Gross Up

In the event that any amount payable by Franchisee to Franchisor under this Agreement or any other agreement entered into pursuant to this Agreement is subject to withholding or other taxes that Franchisee is required to deduct from such payments, Franchisee shall be required to deduct such taxes and remit the same to the applicable governmental authorities. Within the time required by law, Franchisee must complete all forms prescribed by applicable governmental authorities in respect of taxes withheld or paid and provide copies thereof to Franchisor. Franchisee is responsible for and must indemnify and hold Franchisor, its directors, officers, agents and employees harmless against any penalties, interest and expenses incurred by or assessed against Franchisor as a result of Franchisee’s failure to withhold such taxes or to timely remit them to the appropriate taxing authority. Franchisee agrees to fully and promptly cooperate with Franchisor to provide any information or records Franchisor requests in connection with any application by Franchisor to any taxing authority with respect to Franchisee.

C. Other Taxes

Any and all amounts expressed as being payable pursuant to this Agreement are exclusive of any applicable taxes. Accordingly, if applicable, all payments by Franchisee shall, in addition, include an amount equal to any and all goods and services taxes, sales taxes, value added taxes, or other taxes, assessments or amounts of a like nature imposed by law on any

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\(^9\) These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
payments to be made pursuant to this Agreement.

D. Currency

All currency amounts specified in this Agreement are in United States dollars, except for amounts based on a percentage of Gross Sales, which amounts are to be calculated in Canadian dollars. All payments that Franchisee makes under this Agreement and all other agreements entered into pursuant to this Agreement shall be made in United States dollars, unless otherwise specified by us. If amounts are based on a percentage of Gross Sales in Canadian dollars, all such amounts are to be first converted into United States dollars for payment to Franchisor, and must be converted at the spot currency rate announced by Franchisor’s designated bank on the day before the date payment is transmitted; however, if a payment is transmitted after the date payment is due, the currency exchange rate shall be the rate on the date payment was due or the rate as of the date payment is transmitted, whichever rate produces the larger amount in United States dollars.
APPENDIX D

TERM AND RENEWAL

Term

The initial term of this Agreement and the rights granted by Company under this Agreement will begin on the Effective Date and continue for a period of 20 years, subject to earlier termination in accordance with Section 11.

Renewal

Master may, at its option, but subject to compliance with each of the conditions set forth below, renew this Agreement for successive renewal terms of 10 years each. If Master desires to renew this Agreement, each of the following conditions must be met before or at the time of renewal:

- Master must have given Company written notice of Master's election to renew this Agreement not less than six months nor more than 12 months before the end of the initial term.
- Company and Master must have agreed on a Supplemental Development Schedule.
- Master must have satisfied all monetary obligations owed by Master to Company and its Affiliates; Master may not be in default of any provision of this Agreement, nor may Master or any of its Affiliates be in default of any other agreement with Company or any of its Affiliates; and Master and its Affiliates must have substantially and timely complied with all of the monetary obligations and other terms and conditions of this Agreement and those other agreements during their respective terms.
- Master must have executed Company's then-current form of renewal master franchise agreement, which will supersede this Agreement in all respects, and which may contain terms that differ from the terms of this Agreement, including different Royalty and commission rates and different Advertising Contribution or expenditure requirements.
- Master and Master’s Controlling Principals must have executed and delivered to Company a general release (in a form prescribed by Company) of all claims against Company and its Affiliates, and each of their respective officers, directors, shareholders, partners, agents, representatives, independent contractors, servants, and employees, in their corporate and individual capacities, including claims arising under this Agreement or under applicable laws, rules, regulations, or orders.
- Master and Master’s Operating Principal and Managers must be in compliance with Company’s then-current qualifications and training requirements.

10 These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
Effect of Non-Renewal

If Master does not qualify to renew, or elects not to renew, this Agreement, Company will permit Master to assign its rights under this Agreement and all existing Unit Franchise Agreements to a qualified purchaser in accordance with Section 11. If, in the exercise of diligent, good faith efforts by Master, the transfer cannot be completed before the Term's scheduled expiration date, Company may, in its sole discretion, extend the Term from month-to-month for so long as Company believes that Master is continuing to make a conscientious effort to negotiate and complete an assignment. If Company allows Master to extend in order to complete an assignment, Master will operate the franchised business during the interim period in accordance with Company’s then current form of Master Franchise Agreement.

If Master does not qualify to renew, or elects not to renew, this Agreement and the Term therefore expires, immediately after expiration, Franchisee must comply with the requirements of Section 11, and Company will have the rights and remedies provided in Section 11.
APPENDIX E

PERFORMANCE CRITERIA\textsuperscript{11}

1. During the “Development Period” as defined below the table, Master Franchisee agrees to open, cause to be opened by Sub-franchisees, have under construction or development or “Under Lease” (defined as a location or site where Master Franchisee or a Sub-franchisee has executed in good faith a bona fide lease or agreement for an Outlet) within the Territory or the States specified below, and by the dates specified below, the minimum, cumulative aggregate number of Outlets set forth below, in accordance with the following schedule representing the Development Obligation:

<table>
<thead>
<tr>
<th>Development Period Year</th>
<th>California/Neveda (Cumulative)</th>
<th>Other States within the Territory (Cumulative)</th>
<th>Total (Cumulative)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>4</td>
<td>0</td>
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<tr>
<td>2</td>
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<td>10</td>
<td>30</td>
<td>170</td>
<td>200</td>
</tr>
</tbody>
</table>

1.1 The Development Period will equal ten (10) years plus the additional number of months prior to the opening of the first Outlet. For the purpose of Clause 6.1, the first year of the Development Period shall end twelve (12) months after the opening of the first Outlet and each of the following years of the Development Period shall commence on the anniversary of the opening of the first Outlet.

1.2 In addition to Clause 4.1, Master Franchisee agrees to expand the Network of Outlets throughout the Territory such that all Realistic Business Opportunities within the Territory will be appropriately exploited.

1.3 Only an Outlet that is open and operating or an Outlet location or site Under Lease shall be deemed to satisfy the requirements for Master Franchisee’s Development Obligation hereunder. For the avoidance of doubt, a location that ceases to do business in any year shall be able to be counted for the purposes of this clause for that year only if it had been open for 2 years or longer.

1.4 For the purposes of this clause an Outlet shall not be included in the minimum cumulative number of Outlets if it has not generated or is not reasonably projected to generate pro rata annual Net Sales of seventy-five thousand dollars ($75,000.00) per annum.

\textsuperscript{11} These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
1.5 Master Franchisee further agrees that, during the term of this Agreement, it will at all times faithfully, honestly and diligently perform its Development Obligation hereunder and continuously use its best efforts to promote and enhance the sale of Franchise Products within the Territory.

1.6 Master Franchisee shall be in default of the Development Obligation in the Initial Term and any Renewal Terms, and thereby lose its exclusivity in the Territory, only if it has failed at the end of Years 2, 5, 8 and 10 of the Development Period (and Years 2 and 5 of any Renewal Term) to meet two-thirds (2/3) of the aggregate Development Obligation set forth in the chart above. In the event that Master Franchisee has not satisfied its Development Obligation, as set forth herein, then Master Franchisee shall have six (6) months to cure such default following delivery of a written notice of default from Franchisor and, thereby, preserve its exclusivity rights in the Territory.

1.7 Master Franchisee shall not be in breach of its Development Obligations if it shall cure default by paying to Franchisor in respect of each Outlet below the number contained in the Development Schedule the amounts payable under clause # on opening an Outlet and the Minimum Monthly Royalty in respect of such Outlets for 3 months.
APPENDIX F

DEFAULT AND CONSEQUENCES OF DEFAULT

1. Default in meeting targets

1.1 If at the end of each Development Period, Master Franchisee does not have open and operating the number of Stores required to be open and operating at such time, Master Franchisee shall pay to Franchisor, for each month or partial month thereafter that such Store(s) are not open and operating, a fee equal to the Royalty Fee Franchisor would have received had such Store(s) been open and in operation during such months, such payment to be made on or before the tenth (10th) day of each month following the month for which such fee is owed. Such fee shall be calculated for each month in which one (1) or more stores required to be open are not open, by the following formula: the total Monthly Gross Sales over the prior twelve (12) months for all Stores open and operating in the Territory at the end of such development period (including only full months during which such stores were open), divided by the number of store-months used in such calculation, multiplied by the number of stores not open which were required to be open, multiplied by the applicable royalty.

1.2 In lieu of terminating this Agreement pursuant to the preceding Clause, Franchisor shall have the right, in circumstances where it would be entitled to validly terminate the Agreement, to instead vary the terms of this Agreement by written notice to Franchisee in accordance with Clause # such that Franchisee shall be entitled to continue to operate the Outlets then in existence but shall lose all further development rights. Such notice must be given within 30 days of such right accruing, or the right shall lapse. Franchisor shall thereupon be free to engage directly, indirectly or through franchise or license allowing any other person to engage, in the development and operation of Outlets within the Territory so long as the location and opening of any such Outlet does not violate any exclusivity rights under any Franchise Agreement with any Sub-franchisee.

12 These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
APPENDIX G

PERMITTING SUBFRANCHISING

1. Sub-franchising

1.1 Subject to the terms Franchisor hereby grants to Franchisee the right to appoint Sub-franchisees to develop and operate Outlets in the Territory in accordance with the terms and conditions of this Agreement. Franchisee further agrees that prior to its proposal of any third party to become a Sub-franchisee, that Franchisee will determine and represent to Franchisor that each such Sub-franchisee (i) in Franchisee’s reasonable opinion, and based on financial information furnished by such Sub-franchisee, or otherwise in the public domain, has sufficient financial resources and management capabilities to properly develop and operate the proposed Outlet, and (ii) desires to enter into a Franchise Agreement as approved by Franchisee and Franchisee will determine and represent that such proposed franchise will not violate the provisions of this Agreement.

1.2 Any offer or sale of franchise rights to a Sub-franchisee by Franchisee shall be made only in accordance with federal and applicable state law governing the offer and sale of franchises and Franchisee shall provide to Franchisor a copy of its proposed franchise disclosure documents prior to making any offer or sale of a franchisee to a Sub-franchisee as permitted hereunder and prior to filing any disclosure documents with any state governmental authority. Franchisor shall have a right, in its sole discretion, to approve, reject or request modifications to the franchise disclosure documents submitted by Franchisee for approval. Franchisee shall not make any offers and sales of franchises to Sub-franchisees except for offers and sales in compliance with federal and all applicable state laws. Franchisee shall register the UFOC and the Franchise Agreement, if required under applicable state laws, with the appropriate state governmental authorities at its own expense and in a timely manner prior to any such offer and sale of franchises. Further, Franchisee shall update the UFOC, file renewals and maintain effective registration of such UFOC with any governmental authorities within the Territory if required, or if, in the determination of either party, such filing will protect or preserve any of the parties’ rights hereunder.

1.3 Franchisee shall use a standard form of Franchise Agreement approved by Franchisor. The costs incurred by Franchisor in reviewing the agreement and obtaining legal advice shall be borne by Franchisee. The Franchise Agreement shall contain similar obligations with respect to the operation of outlets as contained in Franchisor’s standard unit franchise agreement and this Agreement. Once finalized, the Franchise Agreement shall automatically apply to any Outlet operated by Franchisee as if Franchisor was the franchisor and Franchisee was the franchisee.

1.4 Franchisee shall furnish to Franchisor a copy of each fully executed franchise agreement entered into between Franchisee and any third party, together with such information as Franchisor may reasonably request, including financial information necessary to verify any payments to be made there under.

1.5 Franchisor agrees to cooperate with Franchisee in preparing any franchise disclosure information; provided, however, that Franchisee acknowledges and agrees that Franchisor shall

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13 These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
have no liability or responsibility with respect to any information so furnished to prospective Franchisees. Franchisee further agrees that, to the extent it is required to furnish information, or does furnish information, all information furnished to potential Franchisees shall be true and accurate in all material respects, and shall not fail to contain any information which is material in such Franchisees decision to obtain a license from Franchisee. Franchisor shall have no obligation or liability with respect to any materials furnished, except for information furnished by Franchisor to Franchisee.
APPENDIX H

LOCAL MARKET ADAPTATIONS\textsuperscript{14}

1. Local Market Adaptations

1.1 The Master Franchisee shall be entitled to request that Franchisor consent to a System Variation to take account of local market factors. The Master Franchisee shall provide to Franchisor in writing for its consideration relevant details as to:

(1) the nature and extent of the variation;

(2) the reasons for requesting the variation, including such detail as Franchisor shall require concerning independent market research, competitor information, results of testing or sampling and other relevant facts;

(3) the impact of the proposed change on the revenue or costs of the Master Franchisee’s business.

1.2 Franchisor shall consider such request but shall be under no obligation to approve it. The Master Franchisee must not institute any variation unless and until it has been approved by Franchisor in writing.

\textsuperscript{14} These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
APPENDIX I

DIVISION OF RESPONSIBILITIES

TRAINING AND GUIDANCE

Training

FRANCHISEE must staff and operate the STORE with properly trained personnel. The initial STORE manager appointed by FRANCHISEE in accordance with Section X. of this Agreement and one assistant STORE manager must complete to COMPANY’s satisfaction, within a reasonable period of time not to exceed twelve (12) weeks, a training program in the operation of the STORE. This training program will be provided by COMPANY at no additional charge, except that FRANCHISEE will be responsible for the costs of the training manuals and the expenses of the trainee as indicated below. At least one of the Owners shall attend the introductory portion of the training provided by COMPANY. FRANCHISEE shall administer and monitor completion of COMPANY’s training program by its employees.

Unless COMPANY has trainers capable of training in the Language, (and without implying any obligation to train in the Language, in such event), all training programs conducted by COMPANY’s trainers under this Agreement shall be conducted in the English language. The Principal Owners, Store Manager and any other of FRANCHISEE’s trainees shall be fluent in the English language, unless otherwise permitted by COMPANY. If COMPANY permits and to the extent FRANCHISEE’s trainees require training in a language other than the English language, FRANCHISEE will provide a translator, who shall be approved by COMPANY, for this purpose. FRANCHISEE shall be responsible for the expenses incurred by COMPANY in connection with the training provided hereunder and the translator including, without limitation, costs of transportation, visas, lodging, meals and wages.

Notwithstanding the foregoing, if FRANCHISEE has acquired the STORE through a Transfer or other transaction and COMPANY believes, in its sole discretion, that FRANCHISEE and/or the STORE Manager do not require COMPANY’s standard initial training program, COMPANY may elect, in its sole discretion, to provide FRANCHISEE a limited initial training program or refrain from providing FRANCHISEE any initial training at all.

If COMPANY, in its sole judgment, determines that the STORE is not managed by a properly trained manager, COMPANY shall notify FRANCHISEE and FRANCHISEE shall take appropriate corrective measures, within a reasonable period of time not to exceed twelve (12) weeks, including, without limitation, arranging for the manager and one assistant manager to complete or undergo additional training to COMPANY’s satisfaction. The cost of training (together with any compensation, travel, living and/or other expenses incurred in connection therewith) shall be the responsibility of FRANCHISEE. FRANCHISEE’s failure to appoint a manager trained to COMPANY’s satisfaction shall constitute a material event of default under this Agreement.

At FRANCHISEE’s request, subject to the availability of COMPANY personnel, or if COMPANY in its sole judgment deems it necessary, COMPANY may provide, and the STORE manager

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15 These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
and one assistant manager must complete, additional training at the STORE. COMPANY reserves the right to charge FRANCHISEE a fee representing the costs incurred by COMPANY for such additional training, including compensation of and travel and living expenses incurred by COMPANY personnel in connection with such training. Such fee shall be in addition to the travel and living expenses of and compensation payable for any of FRANCHISEE’s managers and employees attending such training.

Any such additional optional or mandatory new or remedial training programs may be held during the Term at locations designated by COMPANY.

If this Agreement is being executed in connection with the development by FRANCHISEE of a second or other subsequent STORE, FRANCHISEE shall be responsible for conducting all or any portion of the training of its STORE manager and/or employees that COMPANY may require.

Guidance and Assistance

COMPANY will furnish to FRANCHISEE such guidance as COMPANY deems advisable with respect to: (1) specifications, standards and operating procedures utilized by COMPAY Stores and any modifications thereof; (2) purchasing approved equipment, fixtures, furnishings, signs, inventory, and operating supplies and materials; (3) development and implementation of local advertising and promotional programs; (4) administrative, bookkeeping, accounting, inventory control and general operating and management procedures; and (5) establishing and conducting employee training programs at the STORE. In addition, COMPANY will consult with FRANCHISEE about ways to overcome difficulties that FRANCHISEE may experience in dealing with local laws and ordinances (such as zoning ordinances). Such guidance and consultation shall, in the sole judgment of COMPANY, be furnished in the form of COMPANY’s Operating Manual, bulletins, written reports and recommendations, other written materials, refresher training programs and/or telephonic consultations or consultations at the offices of COMPANY or at the STORE or via internet, intranet or other electronic means determined by COMPANY. If requested by FRANCHISEE or deemed necessary by COMPANY, COMPANY will furnish additional guidance and assistance relative to the operation of the STORE at per diem fees and charges established from time to time by COMPANY, subject to the availability of personnel and training resources.
APPENDIX J

ARBITRATION AND MEDIATION

The parties agree that it is in their best interest to resolve disputes between them in an orderly fashion and in a consistent manner. The parties agree as follows:

- The parties shall use their best efforts to resolve and settle by direct, private negotiation any Dispute which arises under or in relation to this Agreement or which concerns the relationship created by this Agreement. Both parties may seek the advice and assistance of legal counsel in connection with any such negotiation;

- Without limiting any of the foregoing, FRANCHISEE and each of the OWNERS acknowledge and agree that COMPANY has the right, at any time, to create or endorse a dispute resolution program and related specifications, standards, procedures and rules for the implementation thereof to be administered by COMPANY or its designees for the benefit of all developers and franchisees conducting business under the System. The standards, specifications, procedures and rules for such dispute resolution program may be made part of the Operating Manual, and FRANCHISEE and the Owners shall comply with all such standards, specifications, procedures and rules in seeking resolution of any claims, controversies or disputes with or involving COMPANY or other developers or franchisees, if applicable under the program. If COMPANY, in its sole discretion, makes such dispute resolution program mandatory, then FRANCHISEE, the Owners and COMPANY hereby agree to submit any claims, controversies or disputes arising out of or relating to this Agreement (and Attachments) for the relationship created by this Agreement for resolution in accordance with such dispute resolution program prior to seeking resolution of such claims, controversies or disputes in the manner described in Sections 0.(3) and (4) (provided that the provisions of Section 0.(5) concerning COMPANY’s right to seek relief in a court for certain actions including for injunctive or other extraordinary relief shall not be superseded or affected by this Section 0.(2), or if such claim, controversy or dispute relates to another developer or franchisee, FRANCHISEE and its Owners agree to participate in the program and submit any such claims, controversies or disputes in accordance with the program’s standards, specifications, procedures and rules, prior to seeking resolution of such claim by any other judicial or legally available means.

If the parties cannot resolve and settle a Dispute by private negotiation within 60 days after one party gives the other written notice that a dispute exists, the parties mutually agree to submit the Dispute to non-binding mediation, as follows:

- mediation shall occur in Dallas, Texas, before a single mediator, using the facilities and mediation rules of the Mediation Organization. If the parties cannot agree on a Mediation Organization, they will use the facilities and international mediation rules of the International Centre for Dispute Resolution;

- the parties shall jointly select a mediator from the panel of mediators maintained by the Mediation Organization. The mediator must be a person experienced in franchising who

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16 These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
has no prior business or professional relationship with either party (including any Owner). If the parties are unable to agree on a mediator within 30 days after the Dispute is submitted to mediation, the Mediation Organization will select a mediator who possesses the indicated qualifications;

- the parties will share the mediation filing fee equally but will otherwise separately bear their own costs and expenses (including legal fees) of participating in the mediation process. Each party agrees to send at least one representative to the mediation conference who has authority to enter into binding contracts on that party’s behalf. Each party further agrees to sign a confidentiality agreement which prohibits the parties or the mediator from disclosing, orally or in writing, any information the other party discloses to the other or the mediator in confidence at any stage of the mediation process; and

- if either party fails or refuses to participate in mediation in accordance with Section 0.(3), the Dispute shall subject to binding arbitration in accordance with Section 0.(4) below.

If the parties cannot fully resolve and settle a Dispute through mediation within 30 days after the mediation conference concludes, all unresolved issues involved in the Dispute shall be submitted to binding arbitration, as follows:

- either COMPANY or FRANCHISEE (on its behalf or on behalf of any Principal Owner) may make a demand for arbitration stating (i) that the notifying party desires to have such Dispute reviewed by a board of three (3) arbitrators and (ii) naming one person whom such party chooses to act as one of the three (3) arbitrators;

- within fifteen (15) days after receipt of such a notice, the other party shall designate one person to act as arbitrator and shall notify the party requesting arbitration of such designation and the name of the person so designated. If the party upon whom a request for arbitration is served fails to designate its arbitrator within fifteen (15) days after receipt of such a notice, then the arbitrator designated by the party requesting arbitration shall act as the sole arbitrator to resolve the controversy at hand;

- if both parties have designated an arbitrator, the two designated arbitrators shall select a third arbitrator who shall have served on no less than three occasions as an arbitrator or mediator in disputes involving commercial businesses which offer and sell products and/or services to consumers internationally. Such third arbitrator shall also be an attorney having substantial experience with and licensed to practice under the laws of the Country and the Country’s legal system who has no prior business or professional relationship with either party (including any Owner) and who agrees to follow and apply the express provisions of this Agreement in determining the arbitration award. If the two designated arbitrators are unable to agree on a third arbitrator within thirty (30) days after the second arbitrator is designated, unless such time is extended by the parties, then either party on five (5) days notice shall apply to the International Centre for Dispute Resolution to designate and appoint such arbitrator who possesses the indicated qualifications;

- the arbitral proceedings shall be conducted in (i) accordance with and shall be subject to the International Centre for Dispute Resolution’s International Rules in effect from time to time; and (ii) the English language. The arbitration proceedings shall be conducted in Arbitration Location, provided that COMPANY may, in its discretion, elect to have the arbitration proceedings conducted in the city in which the FRANCHISEE’s corporate
headquarters is located. The arbitration proceedings shall be administered by the International Centre for Dispute Resolution;

- the decision in writing of the arbitrators shall be (i) in the English language and (ii) final and binding. The party who demands arbitration shall pay the arbitration filing fee, but the parties will otherwise separately bear their own costs and expenses (including legal fees) of participating in the arbitration process. Responsibility for the arbitrator’s fees and expenses shall be determined as part of the arbitrator’s award. Either party may apply to any court having jurisdiction for an order confirming, or to enforce, the award. Subject to Section 0.5, any right of either party to judicial action on any matter subject to arbitration hereunder is hereby waived, except suit to enforce the arbitration award;

- this Agreement and any claim, controversy, dispute or other action arising out of or under this Agreement or related thereto that is referred to arbitration as provided in this Section 0.4 shall be governed and enforced by and under the Agreement Law; and

- the arbitrator(s) shall not extend or modify or suspend any of the terms of this Agreement or the reasonable standards of business performance and operation established by COMPANY. A notice of, or request for, arbitration will not operate to stay, postpone or rescind the effectiveness of any demand for performance or notice of termination.
1. Master Franchisee And Its Owners May Not Transfer Without Approval Of Company

Master Franchisee and each of the Principal Owners understand and acknowledge that the rights and duties created by this Agreement are personal to Master Franchisee and its Principal Owners and that COMPANY has granted the rights under this Agreement to Master Franchisee in reliance upon the individual or collective character, skill, aptitude, attitude, business ability and experience and financial capacity of Master Franchisee and its Principal Owners. Accordingly, no Transfer may be made or attempted to be made, without the prior written approval of COMPANY, which approval will not be arbitrarily withheld. Any Transfer without such approval shall constitute a material breach hereof and convey no rights to or interests in this Agreement, the Franchise, Master Franchisee, any Development Agreement, Subfranchise Agreement or the STORES or in the assets of Master Franchisee or the STORES.

The Principal Owners shall at all time during the Development Period own, directly or indirectly, not less than 51% of all classes of Voting Stock of Master Franchisee.

During the term of this Agreement, any transfer by a Principal Owner of any securities of or ownership interest in Master Franchisee or an entity owning a direct or indirect equity interest in Master Franchisee, this Agreement or any STORE, which are not Voting Stock, shall be subject to the provisions of Section IX.E.1 of this Agreement.

During the Development Period, any transfer by a Principal Owner of any securities of or ownership interests in Master Franchisee or an entity owning a direct or indirect equity interest in Master Franchisee, this Agreement or any STORE, which are Voting Stock, shall be subject to the provisions of Section IX.E.2 of this Agreement; provided, however, that such transfer (other than a sale of such security or ownership interest on the floor of a stock exchange or in an over-the-counter market) shall be deemed a “private offering” for purposes of application of such Section IX.E.2 to such transfer.

After termination or expiration of the Development Period pursuant to the terms of this Agreement, any transfer by a Principal Owner of any securities of or ownership interest in Master Franchisee or an entity owning a direct or indirect equity interest in Master Franchisee, this Agreement or any STORE, which are Voting Stock, shall be subject to the provisions of Section IX.E.3 of this Agreement; provided, however, that such transfer (other than a sale of such security or ownership interest on the floor of a stock exchange or in an over-the-counter market) shall be deemed a “private offering” for purposes of application of such Section IX.E.3 to such transfer.

With respect to any transfer of any security or ownership interest made pursuant to the provisions of this Section IX.B, Master Franchisee shall reimburse COMPANY for its out-of-pocket expenses (including, with limitation, attorneys’ fees and expenses), and reasonable expenses.

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17 These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
internal costs (including, without limitation, per diem charges for COMPANY personnel) incurred in connection with, or arising out of, such transfer.

Conditions For Approval Of Transfer

COMPANY will not arbitrarily withhold its approval of a Transfer. Notwithstanding the foregoing, any or all of the following conditions, as determined by COMPANY in its sole judgment, must be met prior to, or concurrently with, the effective date of any proposed Transfer:

1. Master Franchisee and its Owners shall be in full compliance with all material terms of and conditions arising under this Agreement and all other agreements between Master Franchisee and COMPANY (and/or their respective Affiliates);

2. Master Franchisee and the transferee (if transferee is then a Master Franchisee, developer or franchisee of COMPANY) must pay such fees and other amounts owed by Master Franchisee or such transferee to COMPANY or its Affiliates, which are then due and unpaid;

3. The proposed transferee and its owners must be individuals of good moral character and otherwise satisfy COMPANY’s then applicable criteria and standards for Master Franchisees of COMPANY and if the proposed transferee, its owners or affiliates have any other franchise agreements, development agreements or master franchise agreements with COMPANY, they must be in full compliance with any such agreements and comply with Section (X) below;

4. A Transfer of all or substantially all the assets of or Controlling Interest of or in the Master Franchisee may only be made in conjunction with a Transfer of this Agreement and the assets of all other STORES (including the Development Agreements and Subfranchise Agreements) applicable to the STORES developed pursuant to this Agreement, if applicable;

5. If the Transfer is of a Principal Owner’s or Owner’s interest in the Master Franchisee, the transferee’s name and relevant information shall be added to Attachment C of this Agreement, and the transferee shall then be bound by all provisions applicable to Principal Owner or Owners, as applicable, and execute such documents as COMPANY deems necessary to effectuate the foregoing;

6. To the extent permitted by applicable law, Master Franchisee and its Owners or the transferring Owner(s) and the transferee (if transferee is then a Master Franchisee, developer or franchisee of COMPANY) shall execute a general release, in form prescribed by COMPANY, of any and all claims against COMPANY, its Affiliates and their respective shareholders, officers, directors, employees and agents, representatives, independent contractors, servants and employees, in their corporate and individual capacities, including, without limitation, claims arising under this Agreement or under applicable laws, rules, regulations or orders,

In addition to the above, if the proposed Transfer is of this Agreement or of an Ownership Interest that would result in a change in the Controlling Interest in Master Franchisee, or if the proposed Transfer is one of a series of Transfers which, in the aggregate, constitute the Transfer of this Agreement or of an Ownership Interest that would result in a change in the Controlling Interest in Master Franchisee, any or all of the following conditions, as determined
by COMPANY in its sole judgment, must be met prior to, or concurrently with, the effective date of the proposed Transfer:

7. The transferee and its owners must satisfy COMPANY’s business experience and aptitude criteria and transferee and the proposed Transfer must satisfy COMPANY’s financial criteria for the development of STORES in accordance with this Agreement as such exist at the time of the proposed Transfer. For the purpose of this subparagraph, COMPANY’s business experience criteria includes, but is not limited to, COMPANY’s prohibition on any transferee or its owners from owning, directly or indirectly, or engaging in, or intending to engage in, a Competitive Business and COMPANY’s requirement that transferee and its owners are able to fully comply with the terms and obligations of the then-current form of standard master franchise agreement, including such agreement’s non-competition restrictions;

8. The transferee and its owners, at COMPANY’s option, must agree to execute COMPANY’s then-current form of standard master franchise agreement and such ancillary documents (including undertakings and guarantees) as are then customarily used by COMPANY in the grant of master franchise rights for STORES, modified as necessary to provide for a term equal to the remaining Term;

9. The transferee must agree to complete, and cause its personnel to complete, COMPANY’s training program to COMPANY’s satisfaction;

10. Master Franchisee or the transferee must have paid COMPANY a Transfer Fee;

11. If Master Franchisee and/or its transferring Owner(s) finances any part of the sale price of the Transfer, Master Franchisee and/or its transferring Owner(s) must agree, in a manner satisfactory to COMPANY, that all obligations of the transferee under or pursuant to any promissory notes, agreements or security interests reserved by Master Franchisee and/or its transferring Owner(s) in the assets of the STORES shall be subordinate to the obligations of the transferee to pay any fees and all other amounts due to COMPANY and its Affiliates, and to Master Franchisee’s obligations to otherwise comply with the Master Franchise agreement executed by the transferee;

12. Master Franchisee (in the case of a Transfer of this Agreement) or its transferring Owner(s) must execute a non-competition agreement in favor of COMPANY and the transferee, providing that neither Master Franchisee nor its transferring Owner(s) (whichever is applicable) (through a member of the Immediate Family of Master Franchisee, its Owners or the transferring Owner(s) of Master Franchisee, or otherwise) shall directly or indirectly for a period of two (2) years commencing on the effective date of such Transfer:

(a) have any interest as a disclosed or beneficial owner in any Competitive Business located or operating within an eight (8) mile radius of any STORE; or

(b) assist or make loans to any Competitive Business or perform services as a director, officer, manager, employee, consultant, representative, agent, or otherwise for any Competitive Business located or operating within an eight (8) mile radius of any STORE; or
(c) employ or seek to employ, any person who is employed by COMPANY, its Affiliates or any Master Franchisee, developer or franchisee of COMPANY, nor induce nor attempt to induce any such person to leave said employment without the prior written consent of such person’s employer.

(d) The Transfer must be made in compliance with all applicable laws.

13. In the event COMPANY approves the transferee, COMPANY may, in its sole judgment, release Master Franchisee (or the transferring Owner, in connection with a Transfer by an Owner of its interest) from any indemnification, guaranty or other obligations which arise after the date of any approved Transfer, excluding specifically, (i) any indemnification, guaranty and other obligations which arose or accrued prior to the date of the approved Transfer, (ii) all confidentiality, non-competition and any applicable obligations set out in Section VI.; and (iii) any indemnification, guaranty or other obligation agreed to or contained in any agreement executed by Master Franchisee at the time of the approved Transfer (all of (14)(i), (ii) and (iii) are referred to as “Ongoing Obligations”), but in no event will Master Franchisee’s (or the transferring Owner’s) continuing indemnification obligation (excluding the Ongoing Obligations) extend for more than two (2) years after the date of the approved Transfer.

The restrictions of Section 12 (a) shall not be applicable to the ownership of shares of a class of securities listed on a stock exchange or traded on the over-the-counter market that represent less than three percent (3%) of the number of shares of that class of securities issued and outstanding.

The rights of Master Franchisee and its Owners to transfer interests in this Agreement, Master Franchisee, or the assets of Master Franchisee may be exercised only by the Master Franchisee or its Owners and shall not be exercisable by a receiver, trustee, liquidator or other person acting in a comparable capacity with respect to the assets or ownership of Master Franchisee."

2. Transfer To A Wholly-Owned Corporation/Inter-Owner Transfers

If Master Franchisee is in full compliance with all material terms of and conditions arising under this Agreement and all other agreements between Master Franchisee and COMPANY (and/or their respective Affiliates), COMPANY shall not unreasonably withhold its approval of a Transfer in the case of a proposed Transfer of this Agreement or the STORES to a corporation which conducts no business other than the Master Franchise and the Stores in which Master Franchisee owns and controls one hundred percent (100%) of the equity and voting power of all issued and outstanding capital stock. All certificates representing shares of stock of such corporation must be endorsed with a legend in form approved by COMPANY reciting that the Transfer of shares in Master Franchisee are subject to the restrictions of this Agreement. Such an assignment shall not relieve Master Franchisee of his obligations under this Agreement, and Master Franchisee shall remain jointly and severally liable to COMPANY for all obligations under this Agreement. If requested by COMPANY, Master Franchisee shall execute any and all documents requested by COMPANY evidencing same.

Subject to the terms and conditions of this Agreement, Owners may Transfer (in one or a series of Transfers) up to fifty percent (50%) of their original Ownership Interest in Master Franchisee to another Owner without the consent of, but upon notice to, COMPANY. Such notice shall be accompanied by a description of the then current ownership structure of Master Franchisee.
after such Transfer. In furtherance of the foregoing, Master Franchisee agrees to execute an amendment to Attachment B reflecting the current ownership structure of Master Franchisee after the Transfer of such Ownership Interest. Provided, however, if such Transfer (or series of Transfers) would result in a Transfer of a Controlling Interest, COMPANY’s consent is required.

3. **Death Or Permanent Disability Of Master Franchisee**

Upon the death of Master Franchisee or the permanent disability of Master Franchisee to conduct business affairs or, if Master Franchisee is a corporation or partnership, upon the death or Permanent Disability of a Principal Owner of Master Franchisee, all of such person’s interest in this Agreement, Ownership Interest in Master Franchisee or interest in the assets of Master Franchisee shall be transferred to a transferee approved by COMPANY. Such disposition of this Agreement or such interests (including, without limitation, Transfer by bequest or inheritance), shall be completed within a reasonable time, not to exceed six (6) months from the date of death or Permanent Disability and shall be subject to all of the terms and conditions applicable to Transfers contained in Sections X. and Y. Notwithstanding the foregoing, COMPANY may, in its sole discretion and upon the written request of transferor or its representative, grant transferor an additional six (6) month period to complete said Transfer if Master Franchisee is in full compliance with all material terms of and conditions arising under this Agreement and all other agreements between Master Franchisee and COMPANY (and/or their respective Affiliates); provided, that at any time during such additional six (6) month period COMPANY may, in its sole discretion, assume interim management of any STORE; and provided further, that (i) no such interim management by COMPANY shall relieve Master Franchisee of its obligations under this Agreement; (ii) COMPANY shall not be liable for any debts, losses, costs or expenses incurred in the operation of any STORE during any such period of interim management (except for those caused by the gross negligence or wilful misconduct of COMPANY); (iii) COMPANY shall have the right to charge a reasonable fee for its management services; and (iv) Master Franchisee shall, and hereby does, indemnify and hold COMPANY harmless against any and all judgments, fines, losses, liabilities, costs, amounts paid in settlement and reasonable expenses (including, but not limited to attorneys' fees) incurred in connection with COMPANY’s interim management of any STORE except by reason of COMPANY’s gross negligence or wilful misconduct. Failure to so transfer the interest in this Agreement or such interest in Master Franchisee or Master Franchisee’s assets, within said periods of time shall constitute a material breach of this Agreement.

4. **Public Or Private Offerings**

Securities of Master Franchisee or an entity owning a direct or indirect equity interest in Master Franchisee, or any interest in Master Franchisee’s assets or this Agreement may not be offered to the public pursuant to a private or public offering or any governmentally regulated offering without the prior written consent of COMPANY which may be withheld in COMPANY’s sole judgment. Without implying consent or approval by COMPANY, COMPANY requires that all materials required for such offering under the Agreement Law or pursuant to any other law, regulation or order (including any subsequent filings (and exhibits thereto) required under the Agreement Law or another law, regulation or order) be submitted to COMPANY for review prior to any materials being filed with any government agency, official or authority; and any materials to be used in any exempt offering shall be submitted to COMPANY for review prior to their use. No Master Franchisee offering shall imply (by use of the Marks or otherwise) that COMPANY is participating in an underwriting, issuance, or offering of Master Franchisee’s or COMPANY’s securities; and COMPANY’s review of any offering shall be limited solely to the subject of the relationship between Master Franchisee and COMPANY. Without limiting the foregoing, the
prospectus or other literature utilized in any such offering shall contain the following language in bold face type on the first textual page thereof:

NEITHER COMPANY NOR ANY AFFILIATE THEREOF IS DIRECTLY OR INDIRECTLY THE ISSUER OF THE SECURITIES OFFERED HEREBY, AND NEITHER COMPANY NOR ANY AFFILIATE THEREOF ASSUMES ANY RESPONSIBILITY WITH RESPECT TO THIS OFFERING AND/OR THE ADEQUACY OR ACCURACY OF THE INFORMATION SET FORTH THEREIN WITH RESPECT TO SAID CORPORATION. NEITHER COMPANY NOR ANY AFFILIATE THEREOF ENDORSES OR MAKES ANY RECOMMENDATION WITH RESPECT TO THE INVESTMENT CONTEMPLATED BY THIS OFFERING.

Master Franchisee and the other participants in the offering shall fully indemnify COMPANY in connection with the offering. For each proposed offering, Master Franchisee shall reimburse COMPANY for its reasonable costs and expenses associated with reviewing the proposed offering, including, without limitation, legal and accounting fees and salaries of COMPANY’s personnel. Master Franchisee shall give COMPANY written notice, and provide all materials relating to the offering at least thirty (30) days prior to the date of commencement any offering or other transaction covered by this Section X

5. Effect Of Consent To Transfer

COMPANY’s consent to a Transfer of this Agreement or any Ownership Interest in Master Franchisee or any interest in the assets of Master Franchisee shall not constitute a waiver of any claims it may have against Master Franchisee (or its Owners), nor shall it be deemed a waiver of COMPANY’s right to demand exact compliance with any of the terms or conditions of this Agreement by the transferee.”

6. Company’s Right Of First Refusal

If Master Franchisee or any of its Owners shall at any time determine to sell an interest in this Agreement, the Franchise or the assets of Master Franchisee or an Ownership Interest in Master Franchisee, Master Franchisee or its Owner(s) shall obtain a bona fide, arm’s length, executed written offer from a qualified, responsible, bona fide and fully disclosed purchaser (including, but not limited to, descriptions of the owners of record and beneficially of any corporate or limited liability company offeror and all general and limited partners of any partnership offeror and in the case of a publicly held corporation, partnership, limited liability company or other entity, and copies of the most current annual and quarterly reports. A true and complete copy of the offer (and any proposed ancillary agreements) and terms of any financing arrangements shall immediately be submitted to COMPANY by Master Franchisee, such Owner(s) or both.

The offer must apply only to an interest in this Agreement, the Franchise, the assets of Master Franchisee or Master Franchisee. It must not include the purchase of any other property or rights of Master Franchisee (or such Owner(s)), but if the offeror proposes to buy any other property or rights from Master Franchisee (or such Owner(s)) under a separate, contemporaneous offer, the price and terms of purchase offered to Master Franchisee (or such Owner(s)) for the interest in this Agreement, the assets of Master Franchisee or Master Franchisee shall reflect the bona fide price offered for such interest and shall not reflect any value for any other property or rights.
COMPANY or its designee shall have the right, exercisable by written notice delivered to Master Franchisee or such Owner(s) within thirty (30) days from the date of delivery of an exact copy of such offer to COMPANY and the receipt of all of the information requested by COMPANY to evaluate the offer to purchase such interest for the price and on the terms and conditions contained in such offer. COMPANY or its designee may substitute cash, a cash equivalent, or marketable securities of equal value for any form of payment proposed in such offer; COMPANY’s or its designee’s credit shall be deemed equal to the credit of any proposed purchaser; and COMPANY or its designee shall have not less than sixty (60) days to prepare for closing.

COMPANY or its designee shall be entitled to representations and warranties from Master Franchisee as to the following: (a) due organization, valid existence, good standing and qualification of the entity whose stock and/or assets are being sold (the “Seller”); (b) requisite authority of the Seller to enter into the definitive sale documents (the “Sale Documents”) and to consummate the transactions contemplated thereby; (c) due authorization of the execution, delivery and performance by the Seller of the Sale Documents and the consummation of the transactions contemplated thereby; (d) due execution and delivery of the Sale Documents by the Seller, and the enforceability of such Sale Documents against the Seller; (e) lack of conflict of the Sale Documents, and the transactions described therein, with all applicable laws and all agreements and restrictions binding upon or applicable to the Seller; (f) ownership, condition (to the extent Master Franchisee would have warranted the condition of the assets to the third party offeror) and title to the stock and/or assets being sold pursuant to the Sale Documents; (g) liens, encumbrances and litigation relating to the stock and/or assets being sold pursuant to the Sale Documents; (h) validity and extent of contracts and liabilities, contingent or otherwise, of the Seller; and (i) compliance of the Seller and the assets directly or indirectly being sold with all applicable laws and governmental directives. If COMPANY does not exercise its right of first refusal, Master Franchisee or such Owner(s) may complete the sale to such purchaser pursuant to and on the exact terms of such offer, subject to COMPANY’s approval of the Transfer, as provided for in this Agreement, provided that if the sale to such purchaser is not completed within one hundred twenty (120) days after delivery of such offer to COMPANY, or if there is a change in the terms of the sale, COMPANY or its designee shall have an additional right of first refusal for thirty (30) days on the same terms and conditions as are applicable to the initial right of first refusal.
APPENDIX L

COMPLIANCE WITH U.S. LAWS OF EXTRATERRITORIAL JURISDICTION

1. Master Franchisee shall take all commercially reasonable actions to ensure that each Subdeveloper and Subfranchisee observes and complies with all material statutory and other legal requirements and regulations of laws of the Country consistent with the foregoing requirements imposed upon Master Franchisee.

2. As of the date of this Agreement, Master Franchisee and its Owners shall be and, during the Term shall remain, in full compliance with all applicable laws and regulations that prohibit unfair, fraudulent or corrupt business practices in the performance of its obligations under this Agreement and related activities, including but not limited to making any expenditures other than for lawful purposes or directly or indirectly offering, giving, promising to give or authorizing the payment or the gift of any money, or anything of value, to any person or entity, while knowing or having reason to know that all or a portion of such money or thing of value will be given or promised, directly or indirectly, to any government official, official of an international organization, officer or employee of a foreign government or anyone acting in an official capacity for a foreign government, for the purpose of (a) influencing any action, inaction or decision of such official in a manner contrary to his or her position or creating an improper advantage; or (b) inducing such official to influence any government or instrumentality thereof to effect or influence any act or decision of such government or instrumentality. No government official, official of an international organization, political party or official thereof, or candidate shall have any direct or indirect ownership or investment interest in the revenues or profit of Master Franchisee unless disclosed in writing to COMPANY.

3. Master Franchisee and each OWNER represent and warrant to COMPANY that neither Master Franchisee nor any OWNER is identified, either by name or an alias, pseudonym or nickname, on the lists of “Specially Designated Nationals” or “Blocked Persons” maintained by the U.S. Treasury Department’s Office of Foreign Assets Control (texts available at www.treas.gov/offices/enforcement/ofac/). Further, Master Franchisee and each OWNER represent and warrant that they have not violated and agree that will not violate any law prohibiting corrupt business practices, money laundering or the aid or support of persons or entities who conspire to commit acts of terror against any person, entity or government, including acts prohibited by the U.S. Patriot Act (text available at http://www.epic.org/privacy/terrorism/hr3162.html), U.S. Executive Order 13244 (text available at http://www.treas.gov/offices/enforcement/ofac/sanctions/terrorism.html), or any similar law. The foregoing constitute continuing representations and warranties, and Master Franchisee and each OWNER must notify COMPANY immediately in writing of the occurrence of any event or the development of any circumstance that might render the foregoing representation and warranty false, inaccurate or misleading”.

4. Master Franchisee and each Owner are neither directly nor indirectly owned or controlled by the government of any country that is subject to a United States embargo. Nor does Master Franchisee nor any Owner act directly or indirectly on behalf of the government of any country that is subject to a United States embargo. Master Franchisee agrees that it will notify COMPANY in writing immediately of the occurrence of any event, which renders the foregoing representations and warranties of this paragraph incorrect.

18 These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
5. Master Franchisee and the Owners represent that they understand and have been advised by legal counsel on the requirements of the applicable laws referred to above, including the United States Foreign Corrupt Practices Act (currently located at www.usdoj.gov/criminal/fraud/fcpa.html), any local foreign corrupt practices laws and the Patriot Act (currently located at www.epic.org/privacy/terrorism/hr3162.html), and hereby acknowledge the importance to COMPANY, the System and the parties’ relationship of their respective compliance with the requirements of this Section X., including any applicable auditing requirements and any requirement to report or provide access to information to COMPANY or any government, that is made part of any applicable law. Master Franchisee shall take all reasonable steps to require its consultants, agents and employees to comply with such laws prior to engaging or employing any such persons or entities.
APPENDIX M

WAIVERS

1. Waiver Of Punitive Damages And Jury Trial

TO THE FULLEST EXTENT PERMITTED BY LAW, COMPANY, MASTER FRANCHISEE AND EACH OWNER WAIVE ANY RIGHT TO OR CLAIM OF ANY PUNITIVE, EXEMPLARY, INCIDENTAL, INDIRECT, SPECIAL, CONSEQUENTIAL OR OTHER SIMILAR DAMAGES AGAINST COMPANY, MASTER FRANCHISEE, THEIR AFFILIATES, AND THEIR RESPECTIVE OFFICERS, DIRECTORS, SHAREHOLDERS, PARTNERS, AGENTS, REPRESENTATIVES, INDEPENDENT CONTRACTORS, SERVANTS AND EMPLOYEES, IN THEIR CORPORATE AND INDIVIDUAL CAPACITIES, ARISING OUT OF ANY CAUSE WHATSOEVER (WHETHER SUCH CAUSE BE BASED IN CONTRACT, NEGLIGENCE, STRICT LIABILITY, OTHER TORT OR OTHERWISE); PROVIDED THAT SUCH WAIVER SHALL NOT APPLY TO ANY CLAIM (A) ALLOWED COMPANY FOR LIQUIDATED DAMAGES UNDER THIS AGREEMENT; (B) ALLOWED COMPANY OR MASTER FRANCHISEE FOR ATTORNEY’S FEES OR COSTS AND EXPENSES UNDER THIS AGREEMENT; AND/OR (C) FOR LOST PROFITS BY COMPANY OR MASTER FRANCHISEE AND THE OWNERS UPON OR ARISING OUT OF THE TERMINATION OF THIS AGREEMENT (SUBJECT TO THE LIMITATIONS ON THE LIABILITY OF THE PRINCIPAL OWNERS PURSUANT TO THE PRINCIPAL OWNER’S UNDERTAKING). COMPANY, MASTER FRANCHISEE AND OWNERS AGREE THAT IN THE EVENT OF A DISPUTE, COMPANY, MASTER FRANCHISEE AND THE OWNERS SHALL BE LIMITED TO THE RECOVERY OF ANY DIRECT OR GENERAL DAMAGES SUSTAINED BY THEM, RESPECTIVELY. NOTWITHSTANDING ANYTHING TO THE CONTRARY IN THIS AGREEMENT, IF ANY OTHER TERM OF THIS AGREEMENT IS FOUND OR DETERMINED TO BE UNCONSCIONABLE OR UNENFORCEABLE FOR ANY REASON, THE FOREGOING PROVISIONS OF WAIVER BY AGREEMENT OF PUNITIVE, EXEMPLARY, INCIDENTAL, INDIRECT, SPECIAL, CONSEQUENTIAL OR OTHER SIMILAR DAMAGES SHALL CONTINUE IN FULL FORCE AND EFFECT.

MASTER FRANCHISEE AND EACH OWNER ACKNOWLEDGES THAT THIS SECTION XIII.I. HAS BEEN SPECIFICALLY BROUGHT TO THEIR ATTENTION AND EXPLAINED TO THEM, AND EACH ACKNOWLEDGES THAT THEY HAVE READ AND UNDERSTAND THIS SECTION X HAVE HAD THE OPPORTUNITY TO DISCUSS THIS SECTION WITH THEIR COUNSEL.

_____________________________
Initials of Authorized Representative of
MASTER FRANCHISEE

COMPANY AND MASTER FRANCHISEE AND EACH OWNER BY EXECUTION OF THIS AGREEMENT IRREVOCABLY WAIVE TRIAL BY JURY ON ANY ACTION, PROCEEDING OR COUNTERCLAIM, WHETHER AT LAW OR EQUITY, BROUGHT EITHER OF THEM.

\[19\] These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
2. Waiver of Rights

MASTER FRANCHISEE AND EACH OWNER EXPRESSLY WAIVE THEIR RESPECTIVE RIGHTS UNDER THE TEXAS DECEPTIVE TRADE PRACTICES–CONSUMER PROTECTION ACT, SECTION X.X ET SEQ., BUSINESS AND COMMERCE CODE, A LAW THAT GIVES CONSUMERS SPECIAL RIGHTS AND PROTECTIONS. AFTER CONSULTATION WITH THEIR RESPECTIVE ATTORNEYS, OF THEIR OWN SELECTION, MASTER FRANCHISEE AND EACH OWNER VOLUNTARILY CONSENT TO THIS WAIVER.

INITIALS OF AUTHORIZED REPRESENTATIVE OF
MASTER FRANCHISEE

EXAMPLE 2:

1.1 Your and Our Intentions

You and we mutually agree (and have expressly had a meeting of the minds) that, notwithstanding any contrary provisions of state, provincial or other law, and/or any statements in our Offering Circular required by a state as a condition to registration or for some other purpose:

(i) all issues relating to arbitration and/or the enforcement of arbitration-related provisions of this Agreement will be decided by the arbitrator (including all claims that any terms were procured by fraud or similar means) and governed only by the Federal Arbitration Act (9 U.S.C. § 1 et seq.) and the federal common law of arbitration and exclusive of state statutes and/or common law;

(ii) all provisions of this Agreement (including, but not limited to, ________ and/or _________) shall be fully enforced, including (but not limited to) those relating to arbitration, waiver of jury trial, limitation of damages, venue, choice of laws, shortened periods in which to bring claims;

(iii) you and we intend to rely on federal preemption under the Federal Arbitration Act (9 U.S.C. § 1 et seq.) and, as a result, the provisions of this Agreement will be enforced only according to its terms;

(iv) you and we each knowingly waive all rights to a court trial understanding that arbitration may be less formal than a court or jury trial, may use different rules of procedure and evidence and that appeal is generally less available, but still strongly preferring arbitration as provided in this Agreement; and

(v) the terms of this Agreement (including but not limited to this ________) shall control with respect to any matters of choice of law.
1.2 Terms Applicable To All Proceedings

With respect to any arbitration, litigation or other proceeding of any kind, you and we:

(a) knowingly waive all rights to trial by jury;

(b) knowingly waive any right to make any claims of any kind for, and/or to recover, punitive, exemplary, multiple, pain-and-suffering, mental distress, incidental, consequential, special, lost income and/or profits (except as expressly provided in 0, below) and/or similar damages under any theory whatsoever, as such claims are generally speculative and subject to abuse;

(c) will pursue any such proceeding on an individual basis only, and not on a class-wide or multiple plaintiff basis.

1.3 Limitations On Damages And/Or Remedies

(a) Damages. We shall be entitled to recover the present value of all payments which normally would have been owed by you if the Master Franchise had continued in existence for its full term, together with any past due payments owed to us and/or any Affiliate (in addition to any other remedies available to us in accordance with this Agreement and applicable law). However, your maximum liability, and that of any and all Affiliates of yours, will be limited to US $200,000 total, for any claim, whenever brought under section 4.5 hereof, provided that there shall be no such limitation on indemnity obligations. Our maximum liability, and that of any and all of the Franchisor-Related Persons/Entities, will be limited to US $200,000 total, for any and all claims, whenever brought. The terms of this section are subject to the provisions of __________, below."
APPENDIX N

RIGHTS OF CONSULTATION AND FIRST REFUSAL

EXAMPLE 1:

1. Right of Consultation - No Third Party Offer

1.1 If during the Term Licensor wishes to establish and operate (whether by itself or with one or more third parties) the Service or any part of the Service in a ROFR Country (the “Relevant Service”), Licensor shall first notify Licensee in writing. Licensee shall notify Licensor in writing within thirty (30) Business Days of the date of Licensor’s notice whether Licensee wishes to establish and operate the Relevant Service in the ROFR Country.

1.2 If within thirty (30) Business Days of the date of Licensor’s notice, Licensee notifies Licensor that it does not wish to operate the Relevant Service in the ROFR Country or if Licensor does not receive any notification from Licensee, then Licensor shall be free to continue to investigate, establish and operate a Relevant Service in the ROFR Country without further reference to Licensee. If Licensor has not commenced operation of a Relevant Service within one (1) year from the date of Licensor’s notice, then its obligation in paragraph 1.1 of this Schedule shall revive.

1.3 If within thirty (30) Business Days of the date of Licensor’s notice, Licensee notifies Licensor that Licensee does wish to establish and operate the Relevant Service in the ROFR Country, then Licensee shall have the opportunity, for a period of thirty (30) Business Days, to formulate and propose to Licensor Licensee’s commercial, financial, technical and other plans for such Relevant Service, and Licensor shall in good faith consider Licensee’s proposal. Licensor may thereafter grant or refuse to grant to Licensee rights to operate a Relevant Service in the ROFR Country in its sole discretion and, if it decides to grant such rights, on such terms as it determines in its sole discretion. If Licensor agrees to grant Licensee rights to establish and operate the Relevant Service, Licensee must, within 30 business days of receipt of such notice, execute a license agreement for such Relevant Service.

2. Right of First Refusal - Third Party Offer

2.1 If during the Term Licensor wishes to grant a license for the Relevant Service or any part thereof to any person (the “Third Party”) in a ROFR Country, Licensor shall first obtain from the Third Party a written offer (a “Third Party Offer”) for the Relevant Service. The Third Party Offer shall set out the key terms thereof including, without limitation, the applicable royalty rate(s), payment terms, reporting obligations, the particular Relevant Service to be granted, the brand licensing provisions, guidelines and approval processes, the term of the agreement and any renewal rights, termination rights, and the existence of a parent guarantee or other security. The Third Party Offer may, however, be redacted to protect the privacy and identity of the Third Party.

2.2 For the avoidance of doubt, nothing in paragraph 2.1 above shall require Licensor to disclose to Licensee any approach by a third party in connection with the Relevant Service until

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20 These provisions are intended to be illustrative, and should be considered carefully before being used as a precedent.
discussions between Licensor and the Third Party have reached a stage where it is commercially reasonable for Licensor to require the Third Party to formalise its interest in the form of a Third Party Offer. In particular, nothing in this clause shall require disclosure of the fact or content of any initial discussions or negotiations between the Third Party and Licensor and/or any investigation or due diligence carried out by the Third Party.

2.3 Licensee shall have the right, exercisable by written notice delivered to Licensor within thirty (30) Business Days from the date of delivery to Licensee of the redacted Third Party Offer, to elect to establish and operate the Relevant Service in the ROFR Country on terms no less favorable to Licensor than the terms of the Third Party Offer. For the avoidance of doubt, the expression “terms no less favorable” means that each individual key term is no less favorable to Licensor and does not mean that the key terms taken as a whole are no less favorable to Licensor. If Licensee elects to establish and operate the Relevant Service in the ROFR Country, then Licensee shall execute a binding license agreement with Licensor (a) incorporating the key terms of the Third Party Offer and (b) as to any matters not covered by the key terms, on terms no less favorable to Licensor than the equivalent or most closely comparable terms of the Franchise Agreements. The license agreement shall be executed by Licensee and Licensor within thirty (30) Business Days of Licensee’s written notice electing to establish and operate the Relevant Service.

2.4 If Licensee notifies Licensor that it does not wish to exercise its Right of First Refusal or if Licensor receives no notification from Licensee within that thirty (30) Business Day period referred to in paragraph 2.3 above, then Licensor may grant the right to establish and operate the Relevant Service in the ROFR Country to the Third Party on the terms of the Third Party Offer with no material changes. If Licensor and the Third Party do not enter into a binding agreement for the establishment and operation of the Relevant Service within eighty (80) Business Days after expiry of the twenty (20) Business Days, or there is a material change in the terms of the license, Licensee shall again have an additional right of first refusal for twenty (20) Business Days on the same terms and conditions as are applicable to the initial right of first refusal.”

EXAMPLE 2:

1. Right of First Refusal

(a) If COMPANY or any of its Affiliates shall, at any time during the five (5) year period immediately following the date of execution of the definitive documents evidencing the Transaction, determine to use the Blockbuster trademarks and operating system to develop and operate Units, or to sell the master franchise and license rights to develop and operate Units, in Singapore or South Korea (individually, a “ROFR Country” and collectively, the “ROFR Countries”), COMPANY or its Affiliates shall (i) prepare a written business plan or (ii) obtain a bona fide, arm’s length, executed written letter of intent or other offer from a qualified, responsible, bona fide and fully disclosed prospect, as applicable (collectively, the “Offer”). A true and complete copy of the Offer (and any proposed ancillary agreements) and terms of any financing arrangements shall be submitted to Master Franchisee by COMPANY or such Affiliates within a reasonable period of time following preparation/receipt of the Offer.

(b) The Offer must apply only to one or both of the ROFR Countries. It must not include the purchase of any other property or rights of COMPANY (or such Affiliates), but if a third party offeror proposes to buy any other property or rights from COMPANY (or such Affiliates) under a separate, contemporaneous offer, the price and terms of purchase offered to COMPANY (or
such Affiliates) for the interests as to the ROFR Countries shall reflect the bona fide price offered for such interest and shall not reflect any value for any other property or rights.

(c) Master Franchisee shall have the right, exercisable by written notice delivered to COMPANY (or such Affiliates) within thirty (30) days from the date of delivery of an exact copy of such Offer to Master Franchisee, to evaluate and accept or reject the Offer, on the terms and conditions contained in such Offer. To accept the Offer, Master Franchisee must submit to COMPANY, concurrent with the notice of acceptance, (i) a business plan acceptable to COMPANY that proposes development on no less favorable terms to COMPANY than those set forth in the Offer, and (ii) a non-refundable development deposit in an amount determined by COMPANY in its reasonable business judgment and set forth in the cover letter containing the Offer, but in no event shall such deposit exceed U.S. $2,000,000 per ROFR Country. Failure to accept the Offer within the required time period shall be deemed a rejection of the Offer, and COMPANY shall be permitted to proceed with the transaction contemplated by the Offer itself or with any such third party offeror.

(d) COMPANY shall have the sole right to determine the timeline for the negotiation and execution of definitive agreements for the rights to the ROFR Countries, taking into effect any franchise-specific disclosure obligations in the ROFR Countries, and COMPANY shall retain all rights to revise COMPANY’s standard form international agreements for use in the ROFR Countries, as COMPANY determines is necessary in its sole discretion. In no case shall the timeline for the negotiation and execution of definitive agreements extend beyond one hundred and twenty (120) days from the date Master Franchisee accepts the Offer in accordance with Section 1(c) above, unless specifically consented to in writing by COMPANY. Any failure by Master Franchisee to fully satisfy all the conditions of the Offer or to execute definitive agreements within the express time frames set by COMPANY shall be deemed a waiver of Master Franchisee’s rights under this Right of First Refusal, and COMPANY shall be permitted to proceed with the Offer itself or with any such third party.

(e) Master Franchisee may not transfer or assign this Right of First Refusal to any third party except in connection with a transfer of substantially all of Master Franchisee’s assets; provided that Master Franchisee may exercise its rights under this Right of First Refusal through an Affiliate that is otherwise approved by COMPANY in accordance with its generally applicable requirements for new international master franchisees.”
Stephen Giles

Stephen Giles is a partner in Australian law firm Deacons, practicing in international and domestic franchising, distribution, anti-trust and corporate law from the firm's Melbourne and Sydney offices. He heads Deacons' Asian Franchising Group, comprising 35 lawyers across 15 offices in Australia and Asia. He is rated by Legal Profiles as Australia's leading franchising lawyer, and Deacons is described as "Australia's premier national franchising group". Stephen is author of Franchising Law & Practice, "How to Franchise your Business", "Going International - A Guide for Australian Franchise Systems", "the Franchisor's Manual" and "Compiling a Franchise Operations Manual".

He has been at the forefront of developments in franchising in Australia handling negotiations with the Government on the regulatory framework for the sector. He has served six terms as chairman of the Franchise Council of Australia, is chairman of LAWASIA's Franchising Committee, and a member of the ABA Franchise Forum, the IBA Franchising Committee and the International Franchise Association.
Lou Hedrick Jones

Ms. Jones is Senior Vice President, Corporate and International Law for Blockbuster Inc., responsible for administration of the Blockbuster Law Department, and supervisor of legal support for all Corporate Law and International matters including Domestic and International Franchise and Corporate and International Operations. Prior to coming to Blockbuster, Ms. Jones was a shareholder in the law firm of Thompson & Knight in Dallas, Texas, where she practiced for 14 years in the areas of real estate and franchise law.

Ms. Jones received her Bachelor of Arts degree from the University of Texas – Austin and Juris Doctor degree from Southern Methodist University School of Law. She was admitted to practice law in the State of Texas (1984), and is a member of the American Bar Association; Forum on Franchising; the Texas State Bar Association and the Dallas Bar Association.

Ms. Jones has served on the Corporate Counsel Steering Committee of the Forum on Franchising; International Franchise Association Counsel of Franchise Suppliers; Intellectual Property Sections of the American Bar and Texas State Bar Associations; Dallas Bar Association Sections of Franchising and Real Estate College of the State Bar of Texas. For the American Bar Association she has been a member of the Forum 1993 to the present, on the Corporate Counsel Division from 1998 to present, on the Steering Committee for 2001-2003, and on the International Franchise and Distribution Division Steering Committee 2003 to present.
Larry Weinberg

Larry is a partner at the Toronto law firm of Cassels Brock & Blackwell LLP, and head of the firm’s franchise law practice group. He has a practice that specializes in franchise law and providing all necessary legal services to franchisors. He is a member of the Executive of the Ontario Bar Association’s Joint Subcommittee on Franchising, and has to date organised and chaired four Ontario Bar Association annual franchise law conferences. He is a member of the ABA Forum on Franchising, the International Bar Assn. Committee X (Franchising), the International Franchise Association, and the Canadian Franchise Association. Most recently, in August 2006, he was appointed to serve a two year term as the Director of the International Franchise and Distribution Division of the ABA Forum. In 2004 he acted as co-editor of the ABA Forum on Franchising’s book entitled Fundamentals of Franchising-Canada. As well he was co-editor and co-author of the Canadian Franchise Association’s first and only official book publication entitled, How To Franchise Your Business. In 2004 and again in 2005 Larry was named by Franchise Times to their “Legal Eagles” list of the top 100 franchise lawyers in the United States and Canada. He and Cassels Brock are each listed in the Lexpert® Canadian legal directory as being among the leaders in Canada in franchise law.